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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-27

JEROME S. MURRAY AND GRACE H. MURRAY,
Petitioners

v.

THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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THE UNITED STATES

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The petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Claims in this case.

OPINIONS BELOW

The opinion of the court below was rendered in two stages. The opinion of the Court of Claims on defendant's motion for partial summary judgment (Appendix B, *infra*, pp. 3a-15a) appears at 426 F.2d 376 (1970). The report of the Trial Commissioner (Appendix B, *infra*, pp. 16a-37a) and the opinion of the

Court of Claims adopting that report (Appendix B, *infra*, p. 38a) are not officially reported. The report of the Trial Commissioner is unofficially reported at 727 CCH ¶ 7909.

JURISDICTION

The judgment of the Court of Claims was entered on March 30, 1973 (Appendix B, *infra*, p. 38a). The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTIONS PRESENTED

1. Whether there was an intervening change of law so as to bar the application of the principle of collateral estoppel and allow petitioners to prove that installment proceeds received in 1965 from a sale which occurred in 1955 are taxable as capital gain.

2. Whether petitioners are entitled to capital gains treatment on the sale of two parcels of property held as capital assets within the meaning of section 1221 of the Internal Revenue Code of 1954.

STATUTES INVOLVED

The relevant provisions of sections 1221 and 1234 of the Internal Revenue Code of 1954 are set out in Appendix A, *infra*, pp. 1a-2a.

STATEMENT

The petitioners [1] are husband and wife residing in Annapolis, Maryland. They filed joint Federal income tax returns for the years 1965 and 1966 with the Dis-

[1] Grace H. Murray is a nominal petitioner solely because she executed joint Federal income tax returns for the years in suit. Jerome S. Murray will be hereinafter identified as the petitioner.

trict Director of Internal Revenue, Baltimore, Maryland (App. 25a).[2]

The assets in question are (1) a contract to purchase the Gordon tract assigned by petitioner in 1955 (hereinafter referred to as the "Gordon contract") and (2) the Wilson property sold by petitioner in 1945.

As is pertinent herein, petitioner received installment payments on the Gordon contract during the years 1957, 1961, and 1965 (App. 5a), and received installment payments on the Wilson property in 1960, 1961, and 1965 (App. 30a, 37a). Petitioner's tax years 1957-1961 were previously litigated in the Tax Court, wherein it was found under principles applicable prior to the decision of this Court in *Malat* v. *Riddell*, 383 U.S. 569 (1966), that petitioner had held the Gordon contract for sale in the ordinary course of business and that he was not allowed to report the gain realized on the sale of the Gordon contract as capital gain (App. 5a). Although the question of the character of the gain resulting from the sale of the Wilson property was before the Tax Court, this question was subsequently held by the Court of Claims Trial Commissioner to have not been actually litigated (App. 20a). The opinion of the Tax Court, Jerome S. Murray, 24 T.C.M. 762 (1965) (App. 39a-106a) was affirmed in a *per curiam* opinion of the Court of Appeals for the Fourth Circuit in *Jerome S. Murray* v. *Commissioner*, 370 F.2d 568 (C.A. 4th, 1967) (App. 106a-107a).

Petitioner's tax years 1965 and 1966 were litigated in the Court of Claims (in which the instant petition is filed), wherein it was held (1) that petitioner could

[2] "App." references are to Appendix B of the petition.

not challenge the earlier Tax Court's decision as to the character of the gain realized on the sale of the Gordon contract, and, (2) that petitioner had held the Wilson property for sale in the ordinary course of business and therefore the gain realized on the sale thereof was ordinary income to petitioner.

As previously found by the Tax Court, petitioner on December 8, 1952, entered into a contract to purchase approximately 500 acres owned by the estate of Fulton R. Gordon, located in the Oxon Hill district, Prince Georges County, Maryland. The total purchase price was $2,000 per acre, or approximately 1 million dollars (App. 57a). Petitioner entered into this contract with the stated intent of acquiring the property as a long-term investment with the expectation of mining the sand and gravel, marketing and selling the merchantable timber thereon, and ultimately creating ground rents (App. 87a). Settlement was delayed on the contract of December 8, 1952, because it took approximately one year to survey the property and because of several defects in the Gordon heirs' title to the property (App. 58a).

As a result of a wholly unsolicited offer made in January or February, petitioner entered into a contract with the Mar-Dill Holding Corporation of New York to sell his contract interest in the Gordon tract to Mar-Dill pursuant to an installment sale whereby petitioner realized gain in the amount of $1,890,311.98 (App. 59a-60a).

With respect to petitioner's occupation, the Tax Court found that prior to 1940 a part of petitioner's activity in the real estate business was that of a real estate broker. While he ceased to act as a real estate

broker in the purchase and sale of real estate he retained his real estate broker's license until 1955 since he was advised that such a license was necessary in order to enable him to collect rents. During the years in issue before the Tax Court, petitioner was not listed in the telephone directory as a real estate broker, and he belonged to no association in any way connected with the real estate business. He did no sub-dividing. Other than in 1956 when a bank to which he was indebted required him to reduce his indebtedness, he had no "for sale" signs on any of his properties, and he did not advertise them for sale (App. 42a). The Tax Court accepted petitioner's contention that he was an investor in real estate but concluded, contrary to petitioner's contentions, that he was also engaged in the business of dealing in real estate and/or contractual interests therein during the years before the Tax Court (App. 82a-83a).

Having established the dual occupation of petitioner as both a real estate investor and a real estate dealer, the Tax Court then made a determination as to in which capacity petitioner held the properties in question. The test adopted by the Tax Court was that as one of petitioner's occupations was that of a dealer in real estate, in the absence of *convincing* proof that an item of property was acquired and held by petitioner in his capacity as an investor, it would be concluded that the property in question was held primarily for sale in petitioner's capacity as a real estate dealer. Using this test, the Tax Court held that the sale of the Gordon contract by petitioner in 1955 was the sale of property held for sale, not for investment, by petitioner, and thus the proceeds thereof did not qualify for capital gain treatment (App. 88a).

In the subsequent case before the Court of Claims[3] (in which the instant petition is filed), petitioner urged, in response to the government's claim of collateral estoppel, that the decision of this Court in *Malat* v. *Riddell*, 383 U.S. 569 (1969) constituted an intervening change of law with respect to the definition of property "held primarily for sale in the ordinary course of business," and that in light of this change, the Court of Claims should examine the character of the gain realized on the sale of the Gordon contract *de novo*. Contrary to the explicit rules laid down by this Court in *Commissioner* v. *Sunnen*, 333 U.S. 591 (1948), the Court of Claims held that the decision of this Court in *Malat* v. *Riddell, supra*, did not constitute an intervening change of law so as to bar the application of the principle of collateral estoppel (App. 13a).

With respect to the sale by the petitioner of the Wilson property in 1945, it was held by the Court of Claims Trial Commissioner that petitioner was not collaterally estopped from attacking the ordinary income character of gain asserted by the Internal Revenue Service and upheld by the Tax Court in the earlier described case (App. 20a). The distinction drawn by the Trial Commissioner was that in the case of the Wilson property there had been no factual determination made by the Tax Court, but rather a failure of proof on the issue, whereas in the case of the Gordon

[3] The Commissioner of Internal Revenue asserted deficiencies against petitioner for the years 1965 and 1966 on the grounds, *inter alia*, that petitioner was not entitled to capital gain treatment with respect to the gain realized on the Gordon contract and Wilson property. Petitioner paid the deficiencies, filed timely claims for refund, and thereafter timely filed suit in the Court of Claims for the recovery of the deficiencies so paid. Jurisdiction was vested in the Court of Claims by virtue of 28 U.S.C. Section 1346(a)(1).

contract, there had been a presentation of the facts in the earlier Tax Court litigation (App. 20a-21a).

As is pertinent to petitioner's sale of the Wilson property in 1945, the Court of Claims Trial Commissioner found that until 1946 petitioner specialized in buying what he regarded as bargain-priced residential and combination residential-store properties located in the Metropolitan Washington area. He concentrated on single-family dwellings, small apartment buildings and residential properties that included store space. Generally the properties that were available at prices sufficiently below their potential market values to attract plaintiff's buying interests, required some renovation or repair. He caused the necessary work to be done and offered the properties for rent as soon as they were ready for occupancy. Typically, the lease indentures were month-to-month arrangements with automatic renewal subject to either party's right of termination on 30 days' advance written notice (App. 26a).

On July 7, 1942, petitioner purchased the Wilson property, located at 2412 Nichols Avenue, S.E., Washington, D.C., a two-story brick building with a store location on the ground floor and two apartments above, for the purchase price of $5,585.74. He remodeled it at a cost in excess of $800 and then rented it under a month-to-month written lease for approximately $100 per month. Petitioner rented the property in question from 1942 until 1945, maintaining an occupancy rate during that period averaging approximately 75% (App. 28a). In 1945, the tenants of the 2412 Nichols Avenue property, James and Elsie Wilson, approached petitioner and expressed an interest in buying the building that they occupied (App. 29a). Prior to this approach by the Wilsons, petitioner had never

advertised or offered the subject property for sale (App. 28a-30a). The result was that on August 7, 1945, petitioner sold the Wilsons the property on an installment basis for $12,500 (App. 29a).

Based on these facts, it was determined by the Trial Commissioner, and upheld by the Court of Claims on review, that there was nothing to indicate that in 1945 petitioner was holding the Nichols Avenue property for any purpose other than resale at a profit in the regular course of his real estate business (App. 25a, 38a).

REASONS FOR GRANTING THE WRIT

1. The refusal of the Court of Claims to allow petitioner to establish the investment character of his holding of the Gordon contract in light of this Court's decision in *Malat* v. *Riddell,* 383 U.S. 569 (1966), is in direct conflict with the narrow rules established by this Court in *Commissioner* v. *Sunnen,* 333 U.S. 591 (1945), for applying the bar of collateral estoppel. In *Commissioner* v. *Sunnen, supra,* this Court held that the bar of collateral estoppel may not be invoked to prevent a litigant in a subsequent federal tax case from challenging a determination made in a prior tax case where there has been an intervening "change or development in the controlling legal principles" between the two cases. As stated in *Sunnen* (333 U.S. at 599-600):

> * * * [W]here two cases involve income taxes in different taxable years, collateral estoppel must be used with its limitations carefully in mind so as to avoid injustice. It must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged. . . . If the legal matters determined in the earlier case differ from

> those raised in the second case, collateral estoppel has no bearing on the situation. . . . As demonstrated by *Blair* v. *Commissioner,* 300 U.S. 5, 9, 81 L. ed 465, 469, 57 S. Ct. 330, a judicial declaration intervening between the two proceedings may so change the legal atmosphere as to render the rule of collateral estoppel inapplicable. . . . [A] modification or growth in legal principles as enunciated in intervening decisions of this Court may also effect a significant change in the situation. . . . . In either event, the supervening decision cannot justly be ignored by blind reliance upon the rule of collateral estoppel.

In the proceedings below, the Court of Claims, although recognizing the existence of the *Sunnen* principles, incorrectly applied these principles to the facts of this case. Admittedly, in the absence of an intervening change of law, petitioner would have been collaterally estopped from challenging the earlier determination by the Tax Court, however incorrect, that petitioner held the Gordon contract for sale in the ordinary course of business. However, the ruling of this Court in *Malat* that in the context of the phrase "property held *primarily* for sale" the word "primarily" means "of first importance" or "principally", and not merely "substantially", constituted a significant change in the law which rendered the earlier characterization by the Tax Court of petitioner's holding of the Gordon contract no longer binding on petitioner.

In the earlier Tax Court proceeding, the Tax Court adopted a two-fold approach to determine the character of petitioner's holding of the Gordon contract. It first examined the nature of petitioner's occupation and determined that petitioner was both (1) an investor in real estate and (2) a dealer in real estate. In connec-

tion with this preliminary determination, the Tax Court, by way of a footnote (App. 84a), made a passing reference to the conflicting definitions of "primarily", and stated that regardless of what the word "primarily" meant, one of petitioner's occupations was that of a person holding property "primarily" for sale in the ordinary course of his trade or business.

In light of this determination, the Tax Court then imposed upon petitioner the burden of producing "convincing" proof that he held the items in question as investments; in the absence of such "convincing" proof, it was presumed by the Tax Court that petitioner held the items of property primarily for sale. It had long been urged by the Internal Revenue Service and accepted by the Tax Court that this additional presumption was applicable whenever there was a showing that one of taxpayer's occupations was that of a dealer in real estate. The presumption is fully consistent with the pre-*Malat* holdings of the Tax Court that if one of the "substantial" purposes for holding property is for sale, then it is "primarily" held for sale in the ordinary course of business, an interpretation that was specifically rejected by this Court in *Malat* v. *Riddell, supra.* In light of *Malat,* several Courts of Appeals have further rejected the correctness of the presumption indulged in by the Tax Court. As stated by the Court of Appeals for the Eighth Circuit in *Municipal Bond Corporation* v. *Commissioner,* 382 F.2d 184, 188 (1967):

> We cannot agree with the Commissioner's contention that the taxpayer, merely because he is engaged in the business of holding real estate, is required to introduce more than the normal quantity of evidence to prove that a particular property is not held for sale in the ordinary course of his

> business. *If no evidence* is introduced in the Tax Court, the presumption of correctness of the Commissioner's determination will of course prevail. The burden is upon the taxpayer to overcome such presumption. *The presumption can be met by a preponderance of the evidence.* (Emphasis added.)

See also *Scheuber* v. *Commissioner,* 371 F.2d 996, 998 (C.A. 7th, 1967).

The numerous reversals of the Tax Court by the various Courts of Appeals on the definitional issue of "primarily held for sale" dramatically highlights the Tax Court's resistance to the definition of this phrase as ultimately adopted by this Court in *Malat.* See *Municipal Bond Corporation* v. *Commissioner,* 341 F.2d 683 (C.A. 8th, 1965) rev'g 41 T.C. 20; *Municipal Bond Corporation* v. *Commissioner, supra,* rev'g 46 T.C. 219; *Heller Trust* v. *Commissioner,* 382 F.2d 675 (C.A. 9th, 1967) rev'g T.C. Memo 1966-121 and T.C. Memo 1965-302; and *Scheuber* v. *Commissioner, supra,* rev'g T.C. Memo 1966-107.

A comparison of the ultimate conclusion drawn by the Tax Court to the facts as found by that court clearly shows that the Tax Court had placed upon petitioner the burden of proving by far more than the customary preponderance of the evidence that he held the Gordon contract as an investment. There is no other explanation for the conclusion reached by the Tax Court in light of its fact findings. Petitioner entered into a contract to purchase the 500-acre Gordon tract on December 8, 1952, for a total purchase price approximately $1 million, with the stated intent to mine the land for sand and gravel, to sell the merchantable timber thereon, and ultimately to create ground rents. Petitioner never advertised nor offered the property in question for

sale. As a result of an unsolicited offer brought to petitioner by the real estate broker through which petitioner acquired the property, petitioner in March of 1955 assigned his contract interests in the Gordon tract to the Mar-Dill Holding Corporation of New York for a reported profit of $1,890,311.98. It was recognized by the Tax Court that petitioner engaged in no activities promoting the sale of his interest in the Gordon tract (App. 88a). In order to hold that petitioner held the Gordon tract primarily for sale in light of these facts, there can be no other explanation but that the Tax Court concluded that the petitioner did not meet its burden of showing by more than a preponderance of the evidence that he held the Gordon contract as an investor.

In the Court of Claims below, petitioner attempted to establish, by means of the correct preponderance of evidence standard and in light of this Court's definition of "primarily held for sale", that he in fact had held the Gordon contract as an investment as of the time he disposed of his interest in 1955. The Court of Claims held, however, that petitioner was collaterally estopped from presenting such evidence, dismissing petitioner's argument that *Malat* constituted an intervening change in the law with the following statement (App. 13a):

> . . . There can be no doubt, however, that the rationale expressed in the *Malat* opinion was taken into consideration throughout the [earlier Tax Court] proceedings.

Perhaps this statement by the Court of Claims is born of a less than clear understanding as to both the impact of this Court's decision in *Malat* on the question of

interpreting whether property is held for investment or "primarily for sale", a lack of understanding which has placed the Court of Claims in direct conflict with the Courts of Appeals for the Seventh, Eighth and Ninth Circuits.

2. The legal test adopted by the Court of Claims in determining whether property is held for investment or "primarily for sale" is in conflict with those adopted by the Courts of Appeals for the Seventh, Eighth, and Ninth Circuits. Reduced to its simplest terms, the burden imposed upon a taxpayer by the Court of Claims, once it has been determined that one of taxpayer's occupations is that of a dealer in real estate, is that the taxpayer must show by substantially more than the customary preponderance of evidence that the property in question is other than primarily held for sale in the ordinary course of business. This is also the test that was erroneously adopted by the Tax Court in its pre-*Malat* decision and affirmed on appeal by the Court of Appeals for the Fourth Circuit, involving earlier tax years of petitioner. This test is in direct conflict with that adopted by the Court of Appeals for the Eighth Circuit in *Municipal Bond Corporation* v. *Commissioner,* 382 F.2d 184 (1967), the Court of Appeals for the Seventh Circuit in *Scheuber* v. *Commissioner,* 371 F.2d 996 (1967), and that of the Court of Appeals for the Ninth Circuit in *Heller Trust* v. *Commissioner,* 382 F.2d 675 (1967).

The test utilized by the Court of Claims is, as was true in the previously described Tax Court case, readily seen by comparing the conclusion drawn by the Trial Commissioner that petitioner held the Wilson property "primarily for sale" in light of the applicable facts as they were found to be by the Trial Commissioner. Peti-

tioner had purchased the Wilson property (located at 2412 Nichols Avenue) in July of 1942 for $5,585.74. Petitioner rented the property from 1942 until 1945 for a rental of approximately $100 per month, maintaining an occupancy rate during that period averaging approximately 75%. In 1945, the tenants of the Nichols Avenue property, James and Elsie Wilson, approached petitioner and expressed an interest in buying the building that they occupied. Prior to this approach by the Wilsons, petitioner had never offered the subject property for sale. As a result of this approach by the Wilsons, petitioner on August 7, 1945, sold the Wilsons the property on an installment basis for $12,500. Even assuming, without conceding, that petitioner held this property for dual purposes, i.e., for investment and for sale, it is incomprehensible that based on the foregoing facts the Court of Claims could have concluded that petitioner held this property "primarily for sale". As was previously stated with respect to the prior Tax Court determination of the character of petitioner's holding of the Gordon tract, the only explanation for the Court of Claims' determination of the character of petitioner's holding of the Wilson property was that the Court of Claims also required petitioner to demonstrate by more than a preponderance of the evidence that he did not hold the property "primarily for sale".

This burden imposed upon petitioner by the Court of Claims to establish the investment character of his property holdings is not only in conflict with the approach utilized by the Courts of Appeals for the Seventh, Eighth, and Ninth Circuits, but is also directly contrary to both the letter and the spirit of this Court's decision in *Malat*.

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A

Internal Revenue Code of 1954:

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

• • • •

(26 U.S.C. 1958 ed., Sec. 1221.)

SEC. 1234. OPTIONS TO BUY OR SELL.

(a) TREATMENT OF GAIN OR LOSS.—Gain or loss attributable to the sale or exchange of, or loss attributable to failure to exercise, a privilege or option to buy or sell property shall be considered gain or loss from the sale or exchange of property which has the same character as the property to which the option or privilege relates has in the hands of the taxpayer (or would have in the hands of the taxpayer if acquired by him.

(c) NON-APPLICATION OF SECTION.—This section shall not apply to—

(1) a privilege or option which constitutes property described in paragraph (1) of section 1221;

(2) in the case of gain attributable to the sale or exchange of a privilege or option, any income derived in connection with such privilege or option which, without regard to this section, is treated as other than gain from the sale or exchange of a capital asset;

(3) a loss attributable to failure to exercise an option described in section 1233(c); or

(4) gain attributable to the sale or exchange of a privilege or option acquired by the taxpayer before March 1, 1954, if in the hands of the taxpayer such privilege or option is a capital asset.

(26 U.S.C. 1959 ed., Sec. 1234.)

APPENDIX B

IN THE UNITED STATES COURT OF CLAIMS

No. 364-68

(Decided May 15, 1970)

JEROME S. MURRAY AND GRACE H. MURRAY

v.

THE UNITED STATES

Scott P. Crampton, attorney of record, for plaintiffs. *Stanley Worth, Joseph A. McMenamin, William T. Althoff*, and *Korner, Doyle, Worth & Crampton*, of counsel.

Frances M. Foltz, with whom was *Assistant Attorney General Johnnie M. Walters*, for defendant. *Phillip R. Miller*, of counsel.

Before COWEN, *Chief Judge*, LARAMORE, DURFEE, DAVIS, COLLINS, SKELTON, and NICHOLS, *Judges*.

ON DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

LARAMORE, *Judge*, delivered the opinion of the court:

This is an action to recover alleged overpayments of Federal income tax for the tax years 1965 and 1966. Defendant has moved for partial summary judgment pursuant to Court of Claims Rule 64(b) and (e), with respect to one of the issues raised by plaintiffs in this case, *i.e.*, whether income received in the year 1965 as deferred payment upon a transaction which occurred in 1955 is ordinary income or capital gain.

The pertinent facts alleged by plaintiffs, which we assume to be correct for the purpose of deciding defendant's motion, are as follows: Plaintiffs, Jerome S. Murray and Grace H. Murray, are husband and wife who keep their books and file their Federal income tax returns on the cash basis method of accounting and by calendar years. For the calendar years in suit, 1965 and 1966, plaintiffs as husband and wife filed joint tax returns.[1]

For a number of years prior to 1965, plaintiff had been acquiring real estate in the vicinity of Washington, D.C. Some of these tracts of land produced rental income. Others were unimproved but were being held for the realization of appreciation in value over an extended period of time. On December 8, 1952, Mr. Murray entered into a contract to purchase approximately 500 acres of unimproved real estate in Prince Georges County, Maryland, from the heirs of Fulton R. Gordon, Sr. Thereafter, problems arose with respect to the title to this real estate such that between 1952 and early 1955 the vendors were unable to transfer clear title to the property.

While efforts were being made to resolve these title problems, Mr. Murray was approached by a real estate broker who had a party interested in acquiring his rights to this property. Following extended negotiations resulting from this overture, Mr. Murray ultimately in March 1955 transferred to the Mar-Dill Holding Corporation his interest in the original contract of purchase. Plaintiff at the same time also transferred his interests in several other small tracts which he had acquired in the interim in an effort to clear the title to the original tract and to supplement his anticipated ownership of the entire 500 acres.

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[1] Since the activities of Jerome S. Murray gave rise to the issue now under consideration, Grace H. Murray having merely signed a joint income tax return with her husband, the singular term "plaintiff" when used hereinafter will refer only to Jerome S. Murray.

Plaintiff reported this sale in his Federal income tax return for 1955, under the installment method, as a long-term capital gain. The return was examined by representatives of the Internal Revenue Service, and it was determined that plaintiff had overstated the amount of the gain. Accordingly, the Commissioner of Internal Revenue sent to plaintiff a notice of overassessment in which he determined that plaintiff was entitled to a refund of $556.43, based primarily upon a recomputation of the long-term capital gain from the 1955 sale of the so-called Gordon tract.

The Commissioner of Internal Revenue thereafter, upon examination of the income tax returns filed by plaintiff for the years 1957 through 1961, determined that plaintiff was in the business of dealing in real estate and that collections on the 1955 sale of the Gordon tract should have been reported in 1957 and 1961 as ordinary income. The Commissioner's determination was upheld by the U.S. Tax Court in *Jerome S. Murray,* 24 T.C.M. 762 (1965), and in a *per curiam* opinion by the Fourth Circuit, 370 F.2d 568 (1967). A petition for *certiorari* was denied by the Supreme Court, 389 U.S. 834 (1967).

In 1965 plaintiff received $140,363.16 as an installment payment resulting from the sale in 1955 of his interests in the Gordon tract. The taxable portion of this amount was $125,288.15 and was reported by plaintiff in his Federal income tax return for 1965 as long-term capital gain. The Commissioner of Internal Revenue determined that this $125,288.15 should have been reported as ordinary income and assessed a deficiency which included this adjustment. Plaintiff paid the deficiency, filed a claim for refund, and ultimately brought this suit.

The theory advanced by defendant in support of its motion for partial summary judgment is that plaintiff, by virtue of the Tax Court's decision in *Jerome S. Murray, supra,* as affirmed on appeal, is collaterally estopped from contesting the Internal Revenue Service's determination

that the taxable portion of installment payments received from the 1955 sale of his interests in the Gordon tract was ordinary income. Plaintiff responds that the doctrine of collateral estoppel does not apply to a subsequent proceeding where, as here, there has been (1) a change in the tax year, (2) a change in the factual situation, and (3) a change in the legal climate. Plaintiff also asserts that the notice of overassessment issued by the Commissioner of Internal Revenue for the year 1955 was an official act dictating that in the event of a subsequent inconsistent determination by the Service, the Commissioner must bear the burden of showing that his original determination was erroneous.[2] As will be seen, plaintiff's positions are not well taken. We hold, accordingly, that plaintiff is collaterally estopped from contesting the characterization for tax purposes of the 1955 transaction and the proceeds thereof.

The leading case on the doctrine of collateral estoppel in the field of Federal taxation, relied upon by both parties, is the Supreme Court decision in *Commissioner* v. *Sunnen*, 333 U.S. 591 (1948). The *Sunnen* case involved, *inter alia*, whether the *taxpayer* was taxable on royalty payments received in 1937 by his wife pursuant to a 1928 license contract which the taxpayer had assigned to her; the Board of Tax Appeals, in an earlier proceeding in 1935 dealing with the taxpayer's income tax liability for the years 1929 1931, had concluded that he was *not* taxable on the royalties received by his wife during *those* years under the 1928 license agreement.

Before reaching the merits, the Court addressed itself to whether the above-described issue was capable of disposi-

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[2] On first impression, it appeared that plaintiff was asserting, as had been asserted in the prior *Murray* case, that by his actions the Commissioner *himself* was estopped from challenging the initial treatment of the transaction. A careful review of plaintiff's brief, as supplemented by oral argument, has assured us, however, that plaintiff's statements are instead merely in support of his burden of proof argument.

tion by procedural bar. With respect to collateral estoppel and its relationship to identity of fact and law in consecutive proceedings, the Court stated at pages 599-600:

> • • • [C]ollateral estoppel is a doctrine capable of being applied so as to avoid an undue disparity in the impact of income tax liability. A taxpayer may secure a judicial determination of a particular tax matter, a matter which may recur without substantial variation for some years thereafter. But a subsequent modification of the significant facts or a change or development in the controlling legal principles may make that determination obsolete or erroneous, at least for future purposes. • • •.
>
> And so where two cases involve income taxes in different taxable years, collateral estoppel must be used with its limitations carefully in mind so as to avoid injustice. *It must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged.* • • •. If the legal matters determined in the earlier case differ from those raised in the second case, collateral estoppel has no bearing on the situation. • • • And where the situation is vitally altered between the time of the first judgment and the second, the prior determination is not conclusive. • • • [A] *judicial declaration intervening between the two proceedings* may so change the legal atmosphere as to render the rule of collateral estoppel inapplicable. • • •. [Emphasis supplied; citations and footnote omitted.]

Continuing, by way of emphasis, the Court added at page 601:

> Of course, where a question of fact essential to the judgment is actually litigated and determined in the

> first tax proceeding, the parties are bound by that determination in a subsequent proceeding even though the cause of action is different. * * * And if the very same facts and no others are involved in the second case, a case relating to a different tax year, *the prior judgment will be conclusive as to the same legal issues which appear, assuming no intervening doctrinal change.* * * *. [Emphasis supplied; citation omitted.]

Finally, after setting out the legal principles which comprise the doctrine of collateral estoppel, the Court turned to the application of those principles to the case there under consideration with the following statement at page 603:

> * * * It must therefore be determined whether this *Clifford-Horst* line of cases represents an intervening legal development which is pertinent to the problem raised by the assignment of the 1928 agreement and which makes manifest the error of the result reached in 1935 by the Board. If that is the situation, the doctrine of collateral estoppel becomes inapplicable. A different result is then permissible as to the royalties paid in 1937 under the agreement in question. But to determine whether the *Clifford-Horst* series of cases has such an effect on the instant proceeding necessarily requires inquiry into the merits of the controversy growing out of the various contract assignments from the taxpayer to his wife. To that controversy we now turn. [Footnote omitted.]

The Court, upon examination, concluded that the *Clifford-Horst* line of cases *had* effected an *intervening* change in the controlling legal principles and thereby rendered inapplicable the doctrine of collateral estoppel.

The prior proceeding which forms the basis of defendant's motion here is the Tax Court's decision in *Jerome S. Murray, supra*, as affirmed. Involved in the Tax Court suit

were transactions by Mr. Murray with respect to several of his properties, including the 1955 sale of his interests in the Gordon tract. The Tax Court opinion explicitly utilized a two-step approach, *i.e.*, first an analysis of the taxpayer's real estate activities generally, then an analysis of the taxpayer's activities respecting, and his relationship to, specific property, in reaching its decision.

As to the more basic question regarding the taxpayer's real estate activities generally, that is, whether he was engaged during the relevant period in the business of dealing in real estate (though he may also have been an investor as to certain property) and in which business properties were held for sale, the Tax Court concluded at pages 781-782:

> Because of the number and continuity of Murray's sales of real estate and/or contractual interests therein, the extent and substantiality of such transactions, the nature and extent of petitioner's business, and our conclusion based on the entire record that many items of such property were acquired and held by him, not for the purpose of obtaining income from them as an investor but for the primary purpose of realizing a profit from their sale as a dealer, we are of the opinion that Murray was in the business of selling real estate and/or contractual interests therein during all of the years here in question. [Footnote omitted.]

As to the more specific question regarding the business-investment nature of the taxpayer's relationship to the Gordon tract, the Tax Court concluded at page 783:

> • • • As we have already concluded, Murray was in the business of dealing in such property. Accordingly, and in the absence of any convincing proof that such items of property [*i.e.*, Murray's interests in the Gordon tract] were acquired and held by Murray in his role as an investor, *we conclude that* [*the Gordon*

> *tract interests*] *constituted property held by him primarily for sale in the ordinary course of his business, and that the proceeds of the* [*sale*] *thereof constituted ordinary income.* [Emphasis supplied.]

It is readily apparent that the Gordon tract-aspect of the original *Murray* case and the instant suit exhibit identity of parties, underlying transactions, and issues raised; only the tax years differ. Accordingly, it is our view that, absent the successful avoidance by plaintiff of collateral estoppel on one of the bases delineated in the *Sunnen* case, the immediately preceding identities support a *prima facie* application of the doctrine here.[3] We turn now to plaintiff's arguments in avoidance thereof.

Plaintiff's argument that collateral estoppel should not apply because there has been a change in years (*i.e.*, the two suits involve different and somewhat separated tax years) may be summarily dismissed. Suffice it to say that the *Sunnen* case stands, as much as for anything, for the proposition that collateral estoppel applies in a *later* year to an issue which has been litigated in an earlier year. *See, Commissioner* v. *Sunnen, supra,* at 598-600.

Similarly lacking in merit is plaintiff's misplaced reliance upon an alleged change in the factual situation (*i.e.*, that the nature of plaintiff's activities changed in years subsequent

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[3] We note in passing that plaintiff has referred us to the District of Columbia Tax Court's decision in *Jerome S. Murray* v. *District of Columbia*, 96 Wash. L. Rep. 1161 (1968), wherein it was held, contrary to the holding of the U.S. Tax Court, that certain property (not the Gordon tract) sold in 1957 by Mr. Murray and his co-owner was not held primarily for sale in the ordinary course of business for the purpose of a local tax. This decision, in which the subject matter, underlying transaction, and parties differ from their respective counterparts in the U.S. Tax Court *Murray* case and here, has no bearing on the instant suit.

to the year of sale). This reliance is perhaps attributable to a less than clear understanding of the tax considerations incident to the Gordon tract transaction. Plaintiff elected to report the profit from that transaction under the installment method of section 453 of the Internal Revenue Code of 1954.[4] The function of section 453 is one of timing, not characterization. That is to say, use of the installment method defers the reporting of taxable gain, but in no way characterizes the nature of the gain. Certain statutory prerequisites having been satisfied, either capital gain or ordinary gain may be reported on the installment method, the character of the gain being determined by the nature of the underlying transaction.

Plaintiff's transfer of his interest in the Gordon tract constituted a completed sale in 1955. And, the character of the transactional gain was fixed by the relevant circumstances surrounding that *sole tax-operative event,* irrespective of future changes in dealings or relationships; only the *reporting* of taxable gain was deferred. There was no other tax-operative event occurring in a later year, the tax consequences of which, owing to changed circumstances, might have differed from those incident to the Gordon tract

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[4] Section 453 provides in parts pertinent to this suit:

"(a) DEALERS IN PERSONAL PROPERTY.—

"(1) • • • [A] person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

• • • • • •

"(b) SALES OF REALTY • • •.—

"(1) GENERAL RULE.—Income from—

"(A) a sale or other disposition of real property, or • • • may • • • be returned on the basis and in the manner prescribed in subsection (a)."

transaction.[5] *See, Glidden Co.* v. *United States*, 241 F. Supp. 195 (N.D. Ohio 1964); *Glidden Co.* v. *United States*, (N.D. Ohio), decided October 21, 1966 (18 A.F.T.R. 2d 5933). Accordingly, plaintiff cannot avoid the doctrine of collateral estoppel on the basis of alleged factual changes in later years.

Plaintiff's principal argument in avoidance of the doctrine of collateral estoppel is that a change in the legal climate (*i.e.*, an intervening change in the controlling legal principles) occurred during the interim between the consecutive proceedings. This change, plaintiff urges, was wrought by the Supreme Court's holding in *Malat* v. *Riddell*, 383 U.S. 569 (1966), that the term "primarily," as used in section 1221(1) of the 1954 Code,[6] means "of first importance" or "principally." Theretofore, several courts of appeals were in conflict as to whether a "substan-

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[5] Plaintiff refers to *Arrowsmith* v. *Commissioner*, 344 U.S. 6 (1952), wherein the Supreme Court held that the character of losses sustained by the taxpayers by virtue of their liability as transferees of liquidation distribution assets, though sustained in a year subsequent to liquidation, was nonetheless determined by the character of the earlier liquidation distributions. The diversity of facts and issues involved between the time of liquidation and loss, however, negates any relevance the *Arrowsmith* case might have to the collateral estoppel issue in the instant suit. If anything, *Arrowsmith* endorses the proposition urged by defendant here that the character of plaintiff's gain was, absent a *Sunnen* situation, forever determined by the character of the transaction as it occurred in 1955. In any event, the *Arrowsmith* argument was also raised on appeal and rejected in the *Murray* case.

[6] Section 1221 (1) provides in this respect:

"• • • [T]he term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

"(1) • • • property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; • • •."

tial" purpose satisfied the "primarily" requirement.[7] As indicated by the Supreme Court's holding, it did not.

We agree that the *Malat* decision settled what had been a much-contested question and, to the extent that the term "primarily" was definitively interpreted, modified or changed prior law. We disagree, however, that the *Malat* case constituted an *intervening* change in the legal climate so as to vitiate the doctrine of collateral estoppel in the suit now before us.

The Supreme Court rendered its opinion in the *Malat* case *after* the *Murray* case had been decided by the Tax Court, but *prior to* affirmance by the Fourth Circuit. There can be no doubt, however, that the rationale expressed in the *Malat* opinion was taken into consideration throughout the *Murray* proceedings. In the first instance, the Tax Court's opinion implicitly recognized the definitional conflict which existed regarding the term "primarily" and doubtless intended to cover the possible alternatives with the following footnote:

> We reach this conclusion [that the taxpayer acquired and held many items of property primarily as a dealer, rather than as an investor] regardless of whether the word "primarily" as used in the statutory phrase "held by the taxpayer primarily" is construed to mean "substantially" or to mean "of first importance" or "principally." [Citation omitted.] (24 T.C.M. at 781, fn. 6.)

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[7] The following cases were cited by the Supreme Court with respect to the definitional conflict: *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263 (9th Cir. 1951); *American Can Co.* v. *Commissioner*, 317 F. 2d 604 (2d Cir. 1963), *cert. denied*, 375 U.S. 993 (1964); *United States* v. *Bennett*, 186 F. 2d 407 (5th Cir. 1951); *Municipal Bond Corp.* v. *Commissioner*, 341 F.2d 683 (8th Cir. 1965); *Recordak Corp.* v. *United States*, 163 Ct. Cl. 294, 325 F. 2d 460 (1963).

The possible effect of the *Malat* decision upon the Tax Court decision in *Murray* was considered, moreover, by the Fourth Circuit during the course of the unsuccessful *Murray* appeal, and later upon an unsuccessful petition for rehearing. The Fourth Circuit's *per curiam* affirmance of the Tax Court stated with particular pertinence here at page 568:

> * * * Judge Kern's opinion is entirely consistent with the subsequent decision of the Supreme Court in *Malat* v. *Riddell*, * * *. Nothing in *Malat* requires a modification of the result in the Tax Court. [Citation omitted.]

As already indicated, a petition for *certiorari* was thereafter denied by the Supreme Court.

Neither did the several cases cited by plaintiff that were decided after the *Malat* case constitute an intervening change in the law. *See, Scheuber* v. *Commissioner*, 371 F. 2d 996 (7th Cir. 1967); *Heller Trust* v. *Commissioner*, 382 F. 2d 675 (9th Cir. 1967); *Municipal Bond Corp.* v. *Commissioner*, 382 F. 2d 184 (8th Cir. 1967), *rev'g* 46 T.C. 219 (1966), *on remand from* 341 F. 2d 683 (8th Cir. 1965), *rev'g and remanding* 41 T.C. 20 (1963). These decisions did not effect, nor did they purport to effect any meaningful expansion in the scope of the Supreme Court's interpretation of the disputed language in the *Malat* case. To the contrary, all of these decisions expressly relied upon the legal theory of the *Malat* case, as well as its terminology, in arriving at their respective results.[8] This being so, such decisions can no more provide the basis for avoiding the doctrine of collateral estoppel than could the *Malat* case itself.

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[8] *See, Scheuber* v. *Commissioner, supra*, at 999; *Heller Trust* v. *Commissioner, supra*, at 680; *Municipal Bond Corp.* v. *Commissioner*, 382 F. 2d 184, 187, 188 (8th Cir. 1967).

Plaintiff's final argument has reference to the proper allocation of the burden of proof in a case such as the one before us. The issuance by the Commissioner of Internal Revenue of a notice of overassessment for 1955, based upon the Service's acceptance and favorable modification of plaintiff's return, constituted an official act and as such, so the argument goes, was entitled to the same presumption of correctness as the deficiency notice issued for 1957. On this basis, plaintiff urges the proposition that when by acts of equal dignity the Commissioner has answered the same question inconsistently, he must bear the burden of showing that his original determination was erroneous.

We perceive in plaintiff's burden of proof argument none of the recognized bases delineated in the *Sunnen* case upon which the doctrine of collateral estoppel may be avoided. If plaintiff was of the opinion that the Tax Court in the *Murray* case improperly allocated the burden of proof, the purported error was a proper matter for appeal. We note that the argument relating to the burden of proof was answered in the Tax Court opinion and, as we understand it, the matter was in fact appealed. *See, Jerome S. Murray, supra*, at 782. Since we believe plaintiff to be collaterally estopped from relitigating the central issue, it is of no moment which party here bears the burden of proof with respect thereto, though the foregoing precludes plaintiff from raising the burden of proof argument as well.

In accordance with the above, defendant's motion for partial summary judgment with respect to the Gordon tract transaction is granted, and to that extent plaintiffs' petition is dismissed.

IN THE UNITED STATES COURT OF CLAIMS

No. 364-68

(Filed June 16, 1972)

JEROME S. MURRAY AND GRACE H. MURRAY

v.

THE UNITED STATES

REPORT OF COMMISSIONER TO THE COURT *

Stanley Worth, attorney of record, for plaintiffs, *Joseph A. McMenamin* and *Hamel, Park, McCabe & Saunders*, of counsel.

William Kalish, with whom was *Acting Assistant Attorney General Richard M. Roberts*, for defendant, *Philip R. Miller* and *Joseph Kovner*, of counsel.

Opinion

WILLI, *Commissioner:* The single issue remaining [1] for adjudication in this tax refund suit is the taxable character,

* The opinion, findings of fact, and recommended conclusion of law are submitted under the order of reference and Rule 134(h).

[1] The petition in this court presented a number of issues involving both 1965 and 1966. In dollar value, the largest of those issues concerned the taxability, as ordinary income or capital gain, of $140,363.16 received by plaintiff in 1965 as an installment payment of his 1955 sale of an interest in a certain parcel of Maryland realty known as the Gordon tract. The court decided this issue against plaintiff on the defendant's partial motion for summary judgment. *Murray* v. *United States*, 192 Ct. Cl. 63, 426 F. 2d 376 (1970). The parties have agreed on a settlement disposing of all other issues except that to which this opinion relates.

whether ordinary income or capital gain, of $508.07 received by plaintiff [2] in 1965 as the final installment payment on his $12,500 1945 sale to James and Elsie Wilson of a combination residential-retail store property at 2412 Nichols Avenue, S.E., Washington, D. C.

Though it did not set the matter up in its answer as an affirmative defense,[3] defendant has consistently thereafter relied on collateral estoppel as the initial bar to plaintiff's recovery. Since both parties have oriented their pretrial and trial activities to that issue, defendant's deficiency in pleading does not foreclose the defense. *Erickson* v. *United States*, 159 Ct. Cl. 202, 209-210; 309 F. 2d 760, 764 (1962).

In *Jerome S. Murray*, 24 T.C.M. 762 (1965), *aff'd per curiam*, 370 F. 2d 568 (4th Cir. 1967), *cert. denied*, 389 U.S. 834 (1967), the Tax Court had before it a petition for redetermination of deficiencies proposed by the Commissioner of Internal Revenue in specified amounts for each of the years 1957 through 1961; more than $420,000 in all. (Findings 12 and 13, *infra*.) Included in the Commissioner's proposed deficiencies for 1960 and 1961, albeit without specific identification as to source, were additional income taxes that were in fact attributable to disallowance of plaintiff's capital gain tax treatment of $380.71 and $424.30 received by him in those years respectively as interim installment payments on the 1945 property sale, the final payment on which is the subject matter of the present suit. The deficiencies resulted from taxing those earlier receipts as ordinary income rather than long-term capital gain. (Finding 12, *infra*.)

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[2] Grace H. Murray, Jerome S. Murray's wife, is a nominal plaintiff solely because she executed joint Federal income tax returns with her husband for the years in suit. Since she had no role in any of the tax-operative events involved in this litigation, Jerome S. Murray will be identified throughout this opinion as the plaintiff.

[3] *West Virginia Northern R. R.* v. *United States*, 183 Ct. Cl. 232, 249, 391 F. 2d 627, 636 (1968).

Plaintiff's Tax Court petition sought a redetermination of all of the many and varied deficiency items proposed by the Commissioner, including the two pertaining to the ordinary income characterization of the 1960 and 1961 installment receipts from the Wilsons. (Finding 13, *infra.*)

In the Tax Court trial neither party introduced any evidence concerning the 2412 Nichols Avenue property; plaintiff's acquisition of it; his operation of it as owner; or his sale of the property in 1945 to the Wilsons. Thus, the only references in the entire Tax Court trial record to any aspect of this subject were (1) the 1960 and 1961 deficiencies in tax set up in the Commissioner's 90-day letter; (2) the taxpayer's denial of liability in his petition; and (3) the Commissioner's answering traverse of the taxpayer's allegations of non-liability. (Finding 14, *infra.*)

As originally filed on May 27, 1965, the Tax Court's decision, covering all years in suit and calling for a Rule 50 computation, contained no reference to the issue involving the 1960 and 1961 installment proceeds from the sale of the 2412 Nichols Avenue property. *Jerome S. Murray, supra.* (Finding 15, *infra.*) This omission was formally called to the Court's attention on June 25, 1965 by a Motion For Further Findings of Fact and Reconsideration. (Finding 16, *infra.*)

On July 1, 1965, in response to the taxpayer's motion, the Court entered an order amending its decision of May 27, 1965 by the addition of the following two paragraphs:

> In 1960 and 1961 petitioner collected $380.71 and $424.30 on an installment sale which he made in 1945. Petitioner reported the taxable portions of said collections, or $357.75 and $398.71, respectively, as long-term capital gain, and respondent has determined that said amounts should be treated in 1960 and 1961 as ordinary income. [24 T.C.M. at 780]
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> • • • • •

> Petitioner has failed to prove that respondent erred in his determination that the taxable portions of receipts in the amounts of $380.71 and $424.30 in 1960 and 1961 from an installment sale made in 1945 constituted ordinary income rather than capital gain. [24 T.C.M. at 790]

The defendant now contends that the Tax Court's refusal to upset the Commissioner's ordinary income characterization of the Wilsons' 1960 and 1961 installment payments to plaintiff conclusively attributes the same taxable character to the final payment that he received from them in 1965.

The threshold issue thus framed is whether the principle of collateral estoppel applies to a judgment entered for failure of proof after a proceeding in which no operative facts were affirmatively determined inasmuch as the pleadings were factually inconclusive and no probative evidence was thereafter adduced by either party.

Whether the installment proceeds received by plaintiff from his 1945 sale of the 2412 Nichols Avenue property to the Wilsons are taxable to him as ordinary income or as long-term capital gain depends upon [4] the primary purpose for which he was holding the property at the time of the sale; the critical factual inquiry being whether, at the time, the subject property was "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Sec. 117(a)(1)(A), Internal Revenue Code of 1939, as amended; *Tibbals* v. *United States*, 176 Ct. Cl. 196, 201, 362 F. 2d 266, 268 (1966).

In its definitive expression on the adaptation of collateral estoppel to Federal tax controversies, the Supreme Court emphasized that the cause of action in a subsequent suit is

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[4] It is undisputed that the transaction meets the "sale" and six-month holding period long-term capital gain eligibility requirements of Sec. 117(a)(4) of the 1939 Code.

not "swallowed up" by a prior judgment pertaining to a different taxable year. Rather, the Court explained, the estoppel only operates in the second proceeding as to those matters actually presented and determined in the first. *Commissioner* v. *Sunnen*, 333 U.S. 591, 598-99 (1948). More specifically, the Court identified operative prior determinations as those matters of fact actually litigated in the earlier proceeding and essential to the judgment rendered therein. 333 U.S. at 601. The Court has adhered to that view, observing that the doctrine "makes conclusive in subsequent proceedings only determinations of fact,[5] and mixed fact and law, that were essential to the decision." *Yates* v. *United States*, 354 U.S. 298, 336 (1957). With equal consistency it has declared that only such determinations as are affirmatively made on the merits qualify as viable instruments of estoppel. *United States* v. *International Building Co.*, 345 U.S. 502, 505 (1953); *Ashe* v. *Swenson*, 397 U.S. 436, 444 (1970). This court follows the same rule. *Food Machinery Corp.* v. *United States*, 177 Ct. Cl. 219, 222-23, 366 F. 2d 1007, 1008 (1966).

Unmistakably, the Tax Court disposed of the issue of plaintiff's tax accountability for the 1960 and 1961 receipts from the Wilsons without making any of the factual determinations essential to an adjudication of that question on the merits. Accordingly, consideration of the merits governing taxability of the 1965 installment receipt from the same source is not barred by the doctrine of collateral estoppel.

This conclusion accords with the Tax Court's view that a prior judgment based solely on a failure of proof will not support an estoppel in subsequent litigation of the same substantive issue for a different taxable period. *Theodore B. Jefferson*, 50 T.C. 963, 967 (1968).

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[5] Confinement of the estoppel to determinations that are factual in nature is not peculiar to controversies arising in the tax area. *United States* v. *Utah Constr. Co.*, 384 U.S. 394, 419-21 & n. 18 (1966).

This court's earlier decision on another aspect of the present case serves both to illustrate a proper application of collateral estoppel in a kindred form of tax controversy and to highlight the deficiencies that render it inapplicable on the present record. In *Murray* v. *United States,* 192 Ct. Cl. 63, 426 F. 2d 376 (1970), the court held plaintiff collaterally estopped by the Tax Court's earlier determination that the installment proceeds from his sale of a particular land contract and several small, associated properties yielded ordinary income. In terms of dollar amount, that was the principal issue in the Tax Court litigation that also embraced the relatively miniscule deficiencies attributable to the Commissioner's disallowance of capital gain treatment for the 1960 and 1961 installment payments from James and Elsie Wilson. In contrast to the barren record concerning the sale to the Wilsons, the Tax Court's opinion carefully enumerates the various evidentiary considerations that ultimately persuaded the Court to find[6] that the properties in question were " * * * held by him primarily for sale in the ordinary course of his business * * *." *Jerome S. Murray, supra,* at 770-772, 782-83. In holding plaintiff collaterally estopped from denying ordinary income treatment to a subsequent installment receipt from the same sale, this court expressly alluded to those prior factual determinations of the Tax Court that were essential to its ultimate finding on the merits that plaintiff realized ordinary income from the sale. *Murray* v. *United States, supra,* at 70-71, 426 F. 2d at 380.

Accordingly, defendant's suggestion that its present position is supported by this court's earlier decision in *Murray, supra,* is totally inaccurate. Indeed, it is difficult to conceive of a more distinct study in contrast.

On the merits, plaintiff makes only one contention; that in the prior litigation the Tax Court used rental activity as its predominant criterion for determining whether plain-

[6] 24 T.C.M. at 783.

tiff's receipts from each of his several sales of real estate represented ordinary income or capital gain, the theory being that if a given property had generated rental income for plaintiff it was inferably held by him for investment purposes and therefore merited capital gain treatment when sold. If, on the ather hand, such a property did not yield plaintiff revenue from rent the presumption was that he was holding it for sale to customers in the regular course of his real estate business. Accordingly, plaintiff concludes that had he shown in the Tax Court, as he has here,[7] that at all times prior to the 1945 sale to the Wilsons he operated 2412 Nichols Avenue as a rental property, the Court would have agreed that he was entitled to capital gain treatment on the proceeds of sale.

All else aside, it would be wholly inappropriate for this court to decide the 1965 issue before it by first conjuring a record and then making a judicial guess as to whether another court might have acted differently had it been dealing with such a record rather than that which was actually before it.

Apart from the evident logical infirmities of plaintiff's suggested approach to decision-making, it should be noted that the Tax Court simply did not accord rental activity the dispositive significance that his current argument presupposes. In fact, the Court merely identified " * * * the receipt by the taxpayer during the time he holds the property of substantial rentals from the property or the receipt of rentals over a long period of years * * * " as being among the "important factors" to be considered in determining whether a particular piece of property was held primarily for investment rather than for sale to customers. *Jerome S. Murray, supra,* at 790. In this respect, then, the Tax Court was simply adhering to the universally accepted principle that there is no fixed formula or "rule of thumb" for determining whether a given property is held primarily

[7] Finding 6, *infra.*

for sale to customers in the ordinary course of the taxpayer's business. 3B Mertens, *Law of Federal Income Taxation*, Sec. 22.138 (1966 Rev.), *Oahu Sugar Co.* v. *United States*, 156 Ct. Cl. 546, 552, 300 F. 2d 773, 776-77 (1962).

Moreover, there is no justification for singling out rental evidence as the only item of proof adduced here that should be constructively imparted to the earlier Tax Court record. Finally, there is nothing to suggest that, given the present record in its entirety, the Tax Court would not have concluded, as the weight of all of the evidence seems to require, that when plaintiff sold the 2412 Nichols Avenue property to the Wilsons in 1945 he was primarily holding that property for sale to customers in the regular course of his real estate business.

To the extent that the several issues before the Tax Court for the years 1957 through 1961 concerned the taxable character of profits realized by plaintiff on assorted sales of real estate or interests therein, the Court adopted a two-step approach [8] to decision. First, it determined that during those years (1957-1961) plaintiff was engaged in the business of selling real estate. *Jerome S. Murray*, *supra*, at 781-82. With that general premise thus established, the Court then proceeded to evaluate each controverted sales transaction individually with a view to determining whether, at the time of sale, the property involved was being held by plaintiff primarily for sale to customers in the regular course of his real estate business.

In the present suit the preliminary question focuses on 1945, the year in which plaintiff sold 2412 Nichols Avenue to the Wilsons. If anything, the evidence here is even more compelling than that on which the Tax Court was persuaded in the affirmative. For example, the record shows that in 1945 plaintiff sold 21 of the 44 rental properties that he

[8] This court has previously approved such a two-step analysis of the problem. *Murray* v. *United States*, *supra*, at 70.

maintained under month-to-month leases. (Findings 3 and 10, *infra.*) Certainly the rentals that he derived from his leasing activities would offer no attraction to a prudent investor. In fact, for the year, he realized a net loss of $3,250.49 on his rental operations. (Finding 11, *infra.*)

The evidence bearing on the purpose for which plaintiff was holding 2412 Nichols Avenue in 1945 is equally convincing.

He bought the property in 1942 together with three identical adjoining properties, each consisting of a street-level store with two apartment units above. (Findings 5 and 6, *infra.*) After completing those renovations necessary to occupancy, he rented each building for $100 a month under a standard form of 30-day lease. The use of such an abbreviated term is indicative of the lessor's desire to retain the freedom to sell the demised premises. *Harry Slatkin Builders, Inc.*, 14 T.C.M. 7, 13 (1955).

When plaintiff bought the Nichols Avenue properties for approximately $5,500 each he concluded that they had an optimum potential fair-market value of $12,500. (Finding 8, *infra.*) Such a projection of potential value was in keeping with plaintiff's general practice in acquiring rental properties of this type. His object in such acquisitions was to realize his conception of full value by a future sale, meanwhile maintaining the property in a revenue-producing rental status.[9] *Est. of Eugene Merrick Webb*, 30 T.C. 1202, 1211 (1958); *R. M. Clayton*, 15 T.C.M. 105, 108 (1956), *aff'd per curiam*, 245 F. 2d 238 (6th Cir. 1957).

Clearly, rental of the four adjoining properties was not an economic end in itself from plaintiff's standpoint. In 1945, for example, they generated an aggregate net loss of $928.87. (Finding 11, *infra.*)

In 1945 when plaintiff was first approached by his tenants, the Wilsons, about the sale of 2412, he readily offered

[9] Finding 4, *infra.*

it to them at his target-value figure of $12,500. (Findings 8 and 9, *infra.*)

In sum, there is really nothing in the evidence to indicate that in 1945 plaintiff was holding 2412 Nichols Avenue for any purpose other than resale at a profit in the regular course of his real estate business. 3B Mertens, *Law of Federal Income Taxation,* Sec. 22.145 (1966 Rev.). Accordingly, the profit realized on the sale to the Wilsons is taxable as ordinary income and plaintiffs must consequently be denied recovery on that issue.

Findings of Fact

1. Plaintiffs, husband and wife, reside at Annapolis, Maryland. Grace H. Murray is a plaintiff in this tax refund suit solely because she joined with Jerome S. Murray in filing joint Federal income tax returns for 1965 and 1966, the years in issue. Since Grace H. Murray had no role in any of the tax-operative events involved in this litigation, Jerome S. Murray will be referred to throughout herein as the plaintiff.

2. Ever since 1930 plaintiff, who is now 63, has earned his living from various activities relating directly or indirectly to the ownership and sale of real estate. He began his career doing accounting work for home builders. In due course he advanced construction funds to his builder-clients. With the onset of the depression he encountered collection difficulties that required him in some instances to take over and complete construction of some of the houses on which he had made credit advances. With the knowledge gained from this experience, and with two of his brothers and a sister as associates, he went into the business of building houses for sale.

3. The family-owned-and-operated construction enterprise was dissolved in approximately 1938. Thereupon, in addition to his activities as a licensed real estate broker (which he terminated in 1940, although he retained his

license until 1955), plaintiff initiated a type of a real estate activity that he continued until 1946, at which time he shifted his interests to the acquisition of large commercial and industrial properties and substantial tracts of undeveloped land. Until 1946 he specialized in buying what he regarded as bargain-priced residential and combination residential-store properties located in the Metropolitan Washington area. He concentrated on single-family dwellings, small apartment buildings and residential properties that included store space. Generally the properties that were available at prices sufficiently below their potential market values to attract plaintiff's buying interest, required some renovation or repair. He caused the necessary work to be done and offered the properties for rent as soon as they were ready for occupancy. Typically, the lease indentures were month-to-month agreements with automatic renewal subject to either party's right of termination on 30 days' advance written notice.

In 1945 plaintiff owned outright or, as indicated, had an interest in 44 rental properties of the type described above. The properties were located as follows:

(1) 1321 L Street, NE.
(2) 1244 Franklin Street, NE.
(3) 901-03 New York Avenue & 900 K Street, NW.
(4) 5-7-9 New York Avenue, NW.
(5) 1911 North Capitol Street
(6) 4517 Arkansas Avenue, NW.
(7) 1764 Columbia Road, NW.
(8) 2408 Nichols Avenue, SE.
(9) 2412 Nichols Avenue, S.E.
(10) 2410 Nichols Avenue, SE.
(11) 1026 3d Street, NE.
(12) 2209 M Street, NW.
(13) 28 F Street, NW.
(14) 1529 Gales Street, NE. (50% interest)
(15) 201-03 Tennessee Avenue, NE. (50% interest)
(16) 1644 Columbia Road, NW. (50% interest)

(17) Shelby on the Bay (50% interest)
(18) 1436 Park Road, NW.
(19) 1474 Columbia Road, NW.
(20) 1023 18th Street, NW.
(21) 1307 H Street, NW. (50% interest)
(22) 2214 Shannon Place, SE.
(23) 1504 Seminary Road
(24) 2406 Nichols Avenue, SE.
(25) 38 Myrtle Street, NE.
(26) 331-333 11th and 1105 D Streets, SW.
(27) 1636 E Street, SE.
(28) 1414 16th Street, NW.
(29) 84-86 N Street, SE.
(30) 3127 12th Street, NE. (50% interest)
(31) 338 L Street
(32) 1630 L Street
(33) 472 L Street
(34) 3107 12th Street
(35) 200-06 R Street
(36) 5632 MacArthur Blvd.
(37) 1630 Park Road
(38) 1824 L Street
(39) 1474 Park Road
(40) 1925 Otis Place
(41) 5213 5th Street
(42) 1732 F Street
(43) 915 Sheppard
(44) 1311 Allison

4. Plaintiff's objectives in acquiring properties of the type described in the preceding finding varied, depending upon the particular parcel involved. In most instances his primary objective was realization of a selling price commensurate with his conception of the property's optimum market value; meanwhile holding it in a rental status generating enough revenue to make it largely self-sustaining, at least from a cash cost standpoint. The remaining proper-

ties of this type were acquired by plaintiff as a means of enhancing the value and/or marketability of other contiguous or nearby properties that were either already owned by plaintiff or were the subject of his buying interest.

5. In 1942 plaintiff learned from a friend that four identical and adjoining properties located at 2406, 2408, 2410, and 2412 Nichols Avenue, S.E., Washington, D. C., were owned by an estate that was interested in disposing of them. Each of the units was of two-story brick construction with a store location on the ground floor and two apartments above.

6. On July 7, 1942, plaintiff purchased the four properties described in the preceding finding for $5,585.74 apiece. He remodeled them at a cost in excess of $800 each and then rented them under month-to-month written leases for approximately $100 per month, per building. Although there was some tenant turnover, the type of business conducted in each of the four stores remained constant; one was an appliance sales and service shop; one a small restaurant; one a pick-up and receiving location for an off-premises laundry; and the fourth, the property directly involved in this proceeding, a news and novelty store.

7. Plaintiff rented all four of the Nichols Avenue properties from 1942 until 1945, maintaining an occupancy rate during that period averaging approximately 75 percent.

8. In 1945 the tenant in 2408 Nichols Avenue, a retired marine named Beasley who was operating the restaurant mentioned in finding 6, above, approached plaintiff about buying that property. Although he had taken no affirmative action to promote the sale of his Nichols Avenue holdings, plaintiff was receptive to the tenant's purchase overture because he had experienced some difficulty in attracting and retaining desirable tenants for those properties. Further, he was pessimistic about the future prospects for property values in the neighborhood. In keeping with his

general policy and practice of assigning each of his properties of this type a sales price representing his judgment of maximum potential value, he determined that the figure in the case of these properties was $12,500 apiece. Accordingly, he priced the 2408 location to the tenant at that figure and the sale was formally consummated in July 1945 with plaintiff receiving approximately $2,000 in cash and a note for the balance payable in installments and secured by a second mortgage on the property.

9. In 1945 the tenants in 2412 Nichols Avenue were James and Elsie Wilson. They occupied one of the apartments and operated a news and novelty store on the ground floor. (Finding 6, *supra.*) They learned of the ex-marine's purchase of 2408 and expressed an interest to plaintiff in buying the building that they occupied. The result was that plaintiff sold them the property for the same price, $12,500, payable in part in cash with the balance secured by a note and second mortgage on the property which plaintiff deeded to the Wilsons on August 7, 1945. In October of the same year plaintiff sold 2410 for the same price to a purchaser not identified in the present record and in 1946 he sold 2406, the last of the four properties in the group. The record discloses neither the price nor the purchaser in that transaction.

10. In 1945 plaintiff sold the properties numbered 1 through 21, as enumerated in finding 3, *supra.* Plaintiff's aggregate cost of those properties was $318,996.45 and the total selling price of the same was $346,175.00. Plaintiff had purchased two of those properties in 1939; four in 1942; four in 1943; six in 1944; and five in 1945.

11. As reflected by his 1945 Federal individual income tax return plaintiff's real estate rental operations resulted in a net loss of $3,250.49 for that year. His rental operations of the four adjoining Nichols Avenue properties yielded a combined net loss of $928.87 for the year. He

earned brokerage commissions of $4,803.85 and rental commissions of $794.39 for that year. He spent $485.41 for advertising, none of which was to promote the sale of any of the 21 properties listed in finding 3, *supra*.

12. Pursuant to the 1945 property sale to James and Elsie Wilson, plaintiff received installments payments from them of $380.71 and $424.30 in 1960 and 1961, respectively. On his Federal income tax returns for those years he reported the taxable portions of those installment receipts, or $357.75 and $398.71, respectively, as long-term capital gain. On audit of those returns, as well as plaintiff's returns for 1957 through 1959, the Commissioner of Internal Revenue determined, among many other adjustments, that the foregoing installment receipts were taxable as ordinary income rather than capital gains and proposed tax deficiencies accordingly. In the aggregate, the Commissioner of Internal Revenue asserted tax deficiencies of $401,704.41, $141.75, $17,337.59, $2,573.05, and $4,468.11 for the years 1957, 1958, 1959, 1960, and 1961, respectively. The indicated deficiencies for 1960 and 1961 included the additional taxes resulting from taxation of the $380.71 and $424.30 installment payments received in 1960 and 1961, respectively, as ordinary income rather than long-term capital gain. While that shift in tax treatment is numerically implicit in the total deficiencies asserted in the 90-day letter covering 1960 and 1961, there is no express mention of those installment items in the explanatory portions of that document and, accordingly, no indication of the substantive basis on which the Commissioner reclassified these items as ordinary income rather than capital gain.

13. Plaintiff duly petitioned the Tax Court for a redetermination of all of the deficiencies mentioned in the preceding finding, including those pertaining to the 1960 and 1961 installment receipts from the sale of the Wilson property, as described in finding 12, *supra*. The following excerpts from the petition are the only references that it

contained relative to the taxable status of the 1960 and 1961 installment receipts from the Wilsons:

1960 Installment Collections

* * * * *

5 (cc) Petitioners also collected in 1960 the sum of $380.71 on account of an installment sale which they made in 1945 to James and Elsie Wilson. Petitioners reported 93.97% of the amount received, or $357.75, as long-term capital gain. Respondent has determined that the gain should be treated in 1960 as ordinary income although he allowed prior payments on the same installment sale to be taxed as long-term capital gain. Said $357.75 is also taxable to petitioners in 1960 as long-term capital gain.

1961 Installment Collections

5 (dd) In 1960 petitioners reported taxable installment collections on prior sales as follows:

Adams Property	$ 8,075.00
James and Elsie Wilson	398.71
Marr-Dill Holding Co.	14,710.76
	$23,184.47

Petitioner reported each of said amounts as long-term capital gain. Respondent has determined that each of said amounts is taxable as ordinary income.

(ee) The Adams transaction is described in paragraphs 5(c) and 5(bb) above. The Wilson transaction is described in paragraph 5(cc) above. Each of these transactions resulted in long-term capital gain.

* * * * *

In response to the above allegations, the Commissioner's answer averred as follows:

5 (cc). Admits that the petitioners reported $357.75 as long-term capital gain on their 1960 income tax

return in regard to the Wilson sale and that the respondent has determined that the gain should be treated in 1960 as ordinary income. Denies the remaining allegations contained in subparagraph (cc) of paragraph 5 of the petition.

5 (dd). Admits the allegations contained in subparagraph (dd) of paragraph 5 of the petition, except that the year should be 1961 and not 1960 which petitioners apparently used inadvertently.

5 (ee). Admits that the Adams transaction is described in paragraphs 5(c) and 5(bb) above and that the Wilson transaction is described in paragraph 5(cc) above. Denies the remaining allegations contained in subparagraph (ee) of paragraph 5 of the petition.

The matter set forth above comprises all references in the Tax Court pleadings to the taxation of the 1960 and 1961 installment proceeds received by plaintiff from the Wilsons.

14. In the trial of the suit in the Tax Court neither party introduced any evidence concerning plaintiff's acquisition of the Wilson property; his operation of that property while he owned it; or his disposition of that property in 1945 to the Wilsons. Thus the sole references to that subject in the Tax Court trial record were (1) the 1960 and 1961 deficiencies set up in the Commissioner's 90-day letter; (2) the taxpayer's challenge in his petition to the correctness of those deficiencies; and (3) the Commissioner's denial in his answer of the taxpayer's averment that the installment receipts were improperly characterized as ordinary income in the 90-day letter, all three items as defined in findings 12 and 13, above.

15. Consistent with the absence of any reference to the Wilson transaction in the trial record, the Tax Court's

memorandum decision filed May 27, 1965 contained no reference to that subject. *Jerome S. Murray*, 24 T.C.M. 762. At the outset, the decision identifies all of the issues involved as follows (pp. 763-64):

Memorandum Findings of Fact and Opinion

Respondent determined deficiencies in petitioners' Federal income tax for the years and in the amount as follows:

Year	Deficiency
1957	$401,740.41
1958	141.75
1959	17,337.59
1960	2,573.05
1961	4,468.11

The cases were consolidated for trial, briefing, and opinion.

Petitioners dispute the above deficiencies and claim that they overpaid their taxes for the years 1959 and 1961.

The principal question involved herein is whether respondent properly determined that petitioner Jerome S. Murray held certain real property or contractual interests therein primarily for sale to customers in the ordinary course of his trade or business so that the gain from the sales of such property or interests constituted ordinary income to him. *Specific issues presented for our decision are:* (1) Whether the installment collections reported on petitioners' returns in the years 1957 and 1961 representing gain from the sale of an option to purchase land, referred to herein as the Gordon Tract, together with the sale of small contiguous pieces of land and an option covering

another piece of such land, constitute ordinary income or long-term capital gain in such years; (2) whether installment collections reported on petitioners' returns for the years 1957 and 1959 representing gain from the sale of an option to purchase land, referred to herein as the Berry Option, constitute ordinary income or long-term capital gain in such years; (3) (a) whether the gain from the sale of real property, referred to herein as the Holmes Bakery property, in 1957 constituted ordinary income or long-term capital gain to petitioners, (b) whether petitioners are entitled to a demolition loss arising from the demolition of the buildings thereon in 1957, (c) whether petitioners are entitled to deduct in that year expenses of such demolition, and (d) the correct depreciated basis of such property in the year of its sale; (4) whether the sale of property in 1957 to Georgetown University resulted in ordinary income or capital gain to petitioners and, alternatively, if the gain thereon represents capital gain to petitioners whether the gain on two of the lots in such transaction represents short-term capital gain and the amount thereof; (5) whether petitioners are entitled to postpone recognition of gain from the sale of properties sold by Murray in 1957 and 1960 under threat of condemnation pursuant to section 1033 of the Internal Revenue Code of 1954, and, if not, whether such gain constitutes long-term capital gain pursuant to section 1231 of the Internal Revenue Code of 1954, as petitioners contend, or ordinary income as determined by respondent; and (6) whether the sales of properties identified in the record as (a) the Kent, Weaver Terrace, and MacArthur Boulevard properties, (b) the "Adams" or "Potomac" property, (c) 1620 Wilson Boulevard, and (d) 301 Broad Street resulted in ordinary income or long-term capital gain to petitioners.

The correct amounts of petitioners' self-employment taxes for those years in which they are in issue and their medical expense deductions for the years 1957, 1959, 1960, and 1961 are dependent upon other issues herein and will be determined under Rule 50. At the trial herein petitioners conceded the correctness of respondent's determination that gain in the amount of $6,076.95 in 1958, reported on their return as long-term capital gain, constituted ordinary income. [Emphasis added.]

The opinion of May 27, 1965 concluded with the customary directive that: Decision will be entered under Rule 50.

16. On June 25, 1965, the taxpayer filed a Motion For Further Findings of Fact And For Reconsideration in the Tax Court. That motion began:

COME Now the petitioners, by their attorneys, and MOVE the Court to make further findings of fact in the following particulars and to reconsider its opinion entered herein on May 27, 1965, in the light of the requested additional findings.

1. The Court is requested to find that:

In 1960 and 1961 petitioner collected $380.71 and $424.30 on an installment sale which he made in 1945. Petitioner reported the taxable portions of said collections, or $357.75 and $398.71, respectively, as long-term capital gain, and respondent has determined that said amounts should be treated in 1960 and 1961 as ordinary income. * * *

Respondent has no objection to this proposed finding * * *. While a large amount is not involved, a determination of the status of these collections will be necessary for the Rule 50 computation. Petitioner

contends that this property at 2412 Nichols Avenue * * * was properly reported by him as long-term capital gain * * * as accepted by respondent in years much closer to the transaction * * *.

* * * * *

17. In respect to the above motion, the Tax Court entered the following Order on the date indicated:

On June 25, 1965, petitioners filed herein their Motion for Further Findings of Fact and for Reconsideration. After due consideration of said Motion and the entire record herein, it is

ORDERED: That said Motion be granted in part as follows:

1. That the following paragraph be inserted after the second full paragraph appearing on page 53 of our mimeographed Memorandum Findings of Fact and Opinion:

"In 1960 and 1961 petitioner collected $380.71 and $424.30 on an installment sale which he made in 1945. Petitioner reported the taxable portions of said collections, or $357.75 and $398.71, respectively, as long-term capital gain, and respondent has determined that said amounts should be treated in 1960 and 1961 as ordinary income."

* * * * *

ORDERED: That our mimeographed Memorandum Findings of Fact and Opinion be changed by inserting the following paragraph after the last paragraph appearing on page 84 thereof:

"Petitioner has failed to prove that respondent erred in his determination that the taxable portions of receipts in the amounts of $380.71 and

$424.30 in 1960 and 1961 from an installment sale made in 1945 constituted ordinary income rather than capital gain."

Dated: Washington, D.C., July 1, 1965.

(Signed) JOHN W. KERN,
Judge.

(SEAL)

18. The taxable character of the proceeds received by plaintiff in 1965 as the final installment payment on his 1945 sale of the 2412 Nichols Avenue property to James and Elsie Wilson is the only issue in this litigation remaining for decision, all other issues having been disposed of by settlement or the earlier decision of this court in *Murray* v. *United States,* 192 Ct. Cl. 63, 426 F. 2d 376 (1970).

ULTIMATE FINDINGS OF FACT

19. In 1945 plaintiff was in the business of buying and selling real estate.

20. At the time that plaintiff sold the 2412 Nichols Avenue property to James and Elsie Wilson he was holding that property for sale to customers in the ordinary course of his business as a real estate dealer.

RECOMMENDED CONCLUSION OF LAW

Based upon the foregoing findings of fact, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that, except for those issues on which the parties have heretofore reached an agreed basis of compromise settlement, plaintiffs are not entitled to recover and their petition is dismissed.

IN THE UNITED STATES COURT OF CLAIMS

No. 364-68

JEROME S. MURRAY AND GRACE H. MURRAY

v.

THE UNITED STATES

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges*.

Order

This case comes before the court on plaintiffs' and defendant's requests for review of the recommended decision of Trial Commissioner George Willi, filed June 16, 1972, pursuant to Rule 134(h). The court has considered the case on the exceptions, briefs, and oral argument of counsel. The court agrees with that portion of the commissioner's opinion and findings in which he concluded that the profit which plaintiffs realized on the sale of the real estate in issue is taxable as ordinary income and that plaintiffs are not entitled to recover.

Copies of the commissioner's report have been furnished to the parties, and the court adopts the commissioner's recommended decision to the extent stated as the basis for judgment in this case.

IT IS THEREFORE ORDERED that in accordance with the trial commissioner's opinion and findings that plaintiffs realized ordinary income on the sale of the property in issue, plaintiffs are not entitled to recover and the petition is dismissed.

March 30 1973
BY THE COURT
Chief Judge

NICHOLS, *Judge*, concurs in the result

T. C. Memo. 1965-148

TAX COURT OF THE UNITED STATES

JEROME S. MURRAY AND GRACE H. MURRAY, *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Docket Nos. 4294-62, 2277-63.

Filed May 27, 1965.

Scott P. Crampton, Joseph A. McMenamin, and *L. B. Farr,* for the petitioners.

Joseph N. Ingolia, for the respondent.

Memorandum Findings of Fact and Opinion

Respondent determined deficiencies in petitioners' Federal income tax for the years and in the amounts as follows:

Year	Deficiency
1957	$401,740.41
1958	141.75
1959	17,337.59
1960	2,573.05
1961	4,468.11

The cases were consolidated for trial, briefing, and opinion.*

Petitioners dispute the above deficiencies and claim that they overpaid their taxes for the years 1959 and 1961.

The principal question involved herein is whether respondent properly determined that petitioner Jerome S. Murray held certain real property or contractual interests therein primarily for sale to customers in the ordinary

* Added by Order of May 27, 1965; *infra*, p. 72.

course of his trade or business so that the gain from the sales of such property or interests constituted ordinary income to him. Specific issues presented for our decision are: (1) Whether the installment collections reported on petitioners' returns in the years 1957 and 1961 representing gain from the sale of an option to purchase land, referred to herein as the Gordon Tract, together with the sale of small contiguous pieces of land and an option covering another piece of such land, constitute ordinary income or long-term capital gain in such years; (2) whether installment collections reported on petitioners' returns for the years 1957 and 1959 representing gain from the sale of an option to purchase land, referred to herein as the Berry Option, constitute ordinary income or long-term capital gain in such years; (3) (a) whether the gain from the sale of real property, referred to herein as the Holmes Bakery property, in 1957 constituted ordinary income or long-term capital gain to petitioners, (b) whether petitioners are entitled to a demolition loss arising from the demolition of the buildings thereon in 1957, (c) whether petitioners are entitled to deduct in that year expenses of such demolition, and (d) the correct depreciated basis of such property in the year of its sale; (4) whether the sale of property in 1957 to Georgetown University resulted in ordinary income or capital gain to petitioners and, alternatively, if the gain thereon represents capital gain to petitioners whether the gain on two of the lots in such transaction represents short-term capital gain and the amount thereof; (5) whether petitioners are entitled to postpone recognition of gain from the sale of properties sold by Murray in 1957 and 1960 under threat of condemnation pursuant to section 1033 of the Internal Revenue Code of 1954, and, if not, whether such gain constitutes long-term capital gain pursuant to section 1231 of the Internal Revenue Code of 1954, as petitioners contend, or ordinary income as determined by respondent; and (6) whether the sales of properties identified in the record as (a) the Kent,

Weaver Terrace ,and MacArthur Boulevard properties, (b) the "Adams" or "Potomac" property, (c) 1620 Wilson Boulevard, and (d) 301 Board Street resulted in ordinary income or long-term capital gain to petitioners.

The correct amounts of petitioners' self-employment taxes for those years in which they are in issue and their medical expense deductions for the years 1957, 1959, 1960, and 1961 are dependent upon other issues herein and will be determined under Rule 50. At the trial herein petitioners conceded the correctness of respondent's determination that gain in the amount of $6,076.95 in 1958, reported on their return as long-term capital gain, constituted ordinary income.

Findings of Fact

Some of the facts are stipulated and are hereby found as stipulated.

Petitioners are husband and wife, residing in Annapolis, Maryland. They filed joint Federal income tax returns for the years here involved with the district director of internal revenue at Baltimore, Maryland. Petitioner Grace H. Murray is involved herein by virtue of having filed joint returns with her husband. Petitioner Jerome S. Murray will sometimes hereinafter be referred to as Murray or petitioner.

Murray's Real Estate Transactions

Petitioner entered the real estate business in the early 1930's. His principal activities in that business were in Washington and the adjacent areas of Maryland and Virginia. In the course of that business he has bought and sold real estate, appraised real estate, and has attended between 100 and 200 settlements incident to the purchase or sale of real estate. Around 1940 he began to erect buildings or to remodel existing buildings or real estate for the purpose of creating and collecting rents therefrom. A

number of his real estate ventures were carried on jointly with other individuals and at least one, involving the Dupont Circle Building, was carried on for a time through a corporation (later dissolved) in which he and another individual each held approximately half of the stock. Prior to 1940 a part of petitioner's activity in the real estate business was that of a real estate broker. While he ceased to act as a real estate broker in the purchase and sale of real estate he retained his real estate broker's license until 1955 since he was advised that such a license was necessary in order to enable him to collect rents. During the years here in issue Murray was not listed in the telephone directory as a real estate broker, and he belonged to no association in any way connected with the real estate business. He did no subdividing. Other than in 1956 when a bank to which he was indebted required him to reduce his indebtedness, he had no "for sale" signs on any of his properties, and he did not advertise them for sale.

In his income tax returns for the years 1949 through 1963 Murray made the following statements concerning his occupation:

Year	Occupation
1949	Real Estate
1950	" "
1951	" "
1952	" "
1953	" "
1954	Retail Merchant
1955	Rental Property and Retail Merchant
1956	No Occupation Given
1957	" " "
1958	" " "
1959	" " "
1960	Investor—Real Estate
1961	" " "
1962	Investments—Real Estate Rental Properties
1963	Investor

In 1955 Murray stated in deposition that he had been in "the real estate business" since approximately 1930.

In 1954 petitioner as sole proprietor began the operation of a retail dry goods business, which he carried on in a building known as the Stewart Building, owned by him at Sixth and D Streets, N.W., Washington, D. C. This business was operated under the style of Stewart's Corner, and was unprofitable, operating at a loss of $14,024.20 during the period July 1 to December 31, 1954, and at a loss of $39,048.92 during the time he operated it in 1955. On or about March 25, 1955, petitioner caused the incorporation of Stewart's Corner, Inc., which will be sometimes referred to hereinafter as Stewart's Corner, with powers not only to operate a retail business but also with broad powers to engage in activities connected with real estate. On or about April 1, 1955, petitioner transferred all of the assets of his sole proprietorship to the corporation in return for all of its stock. One of its officers named Althoff was a son-in-law of petitioner and was a licensed real estate broker. At or about the same time petitioner, on the advice of his accountant, gave up his own license as a real estate broker. Thereafter, Stewart's Corner managed some of petitioner's rental property, acquired and sold interests in certain real estate, and was used as a "straw man" in certain of petitioner's personal real estate transactions. The retail business of Stewart's Corner continued to be unprofitable having operating losses of $73,597.50 in its fiscal year 1956 and $105,000.36 in its fiscal year 1957. At the end of that year it terminated its retail dry goods business.

Stewart's Corner acquired in 1955 the following properties with funds advanced to it by Murray plus the execution of mortgage notes or the assumption of existing mortgages. A tract at 1612 K Street, Washington, D. C., acquired for approximately $154,000; a tract at 9th and E Streets, N.W., Washington, D. C., for approximately $133,000, of which Murray advanced approximately $41,000; 731 to 733 4th

Street, N.W., Washington, D. C., for approximately $27,600; a tract on 25th Street, N.W., Washington, D.C., acquired for approximately $55,000, of which approximately $42,600 was advanced by Murray; and 727-729 4th Street, N.W., Washington, D. C., acquired for approximately $30,000.

In 1956 Stewart's Corner acquired the following properties with funds advanced by Murray plus the execution of mortgage notes or the assumption of existing mortgages: 510 2nd Street, N.W., Washington, D. C., for approximately $16,000; 513 3rd Street, N.W., Washington, D. C., for approximately $16,000; approximately 7 acres in Oxon Hill, Maryland, for approximately $40,000; 1731 Moore Street, Rosslyn, Virginia, for approximately $51,000; and a tract in Montgomery County, Maryland, located at the corner of Viers Mill Road and Georgia Avenue, upon which the corporation built in 1958 a gasoline station and leased it to Sinclair for 20 years at a cost of approximately $135,000 for the land and $50,000 for the building.

In 1957 Stewart's Corner acquired the following properties with funds advanced by Murray plus the execution of mortgage notes or the assumption of existing mortgages: 127-129 F Street, N.W., Washington, D. C. (part of the Holmes Bakery property which will be referred to again in these Findings), for approximately $155,000; 606-607 6th Street, N.W., Washington, D. C., for approximately $10,000; 615 2nd Street, N.W., Washington, D. C., for approximately $10,000; 400 I Street, N.W., Washington, D. C., for approximately $6,000; 201-205 E Street, N.W., Washington, D.C.; 129 F Street, N.W., Washington, D.C., for approximately $8,000; and 501-509 G Street, N.W., Washington, D. C., for approximately $30,000.

In 1959 the corporation purchased real estate at 2300 Rhode Island Avenue, Washington, D. C., for $35,293.10.

In 1961 the corporation sold to Murray its Sinclair gasoline station in Montgomery County, Maryland for

$231,458.37. Murray purchased the property because it was a good investment, and he still owns it. He paid his corporation the fair market value for the property.

Murray directed the operations of Stewart's Corner and made the decisions as to which properties it would purchase and sell.

When Murray loaned money to Stewart's Corner, he received no notes in return and Stewart's Corner paid him no interest.

Stewart's Corner owed Murray the following amounts as of December 31 in the years indicated:

Year	Amount
1955	$209,455.26
1956	250,914.50
1957	263,470.80
1958	265,971.41
1959	223,141.18
1960	207,605.75

Stewart's Corner also obtained loans from banks from time to time not only on the strength of its own financial statement but also, and more importantly, on the personal endorsement of Murray and his wife on notes executed by Stewart's Corner.

The books of Stewart's Corner were kept in its own office along with Murray's personal books during the years 1955 and 1956. Subsequent to that time they were kept in Murray's home with Murray's personal books. A clerk hired to keep the books of Stewart's Corner and Murray during the years 1955 through 1958 was paid a salary by Stewart's Corner only.

Petitioners' personal income tax returns disclose the following sales of real estate or interest therein made by Murray:

Year	Description	Period of Holding	Profit to Murray	
1941	1121 6th St., N.W.	Not shown	$622.80	(deferred profit as of 12/31/47)
1943	2305 18th St., N.W.	Not shown	10,405.27	"
1944	3 N. Y. Ave., N.W.	Not shown	703.81	"
1945	1244 Franklin St., N.E.	5 mos.	660.78	"
1945	5-7-9 N. Y. Ave., N.W.	11 mos.	4,702.91	"
1945	2408 Nichols Ave., S.E.	3 yrs.	4,083.65	"
1945	2412 Nichols Ave., S.E.	3 yrs., 1 mo.	4,064.97	"
1945	2410 Nichols Ave., S.E.	3 yrs., 3 mos.	3,861.19	"
1947	Bethesda Bowling Center	Not shown	13,411.03	(deferred profit as of 12/31/48)
1949	Chain Bridge Property	4 yrs., 4 mos.	1,997.08	
1949	2151 K St., N.W.	5 mos.	3,621.96	
1951	38 Penn. Ave., S.E.	8 yrs., 11 mos.	3,057.44	
1954	1707-9-11 Eye St., N.W.	1 yr., 5 mos.	64,436.67	
1955	1000 Conn. Ave., N.W.	6 mos.	49,309.24	
1955	1919-25 M St., N.W.	8 mos.	24,142.66	
1955	1628 K St., N.W.	9 yrs.	46,693.54	
1955	Indian Head Heights	1 yr., 8 mos.	41,900.53	
1955	Gordon Estate	2 yrs., 4 mos.	1,890,311.98	
1956	1719 Eye St., N.W.	2 yrs., 2 mos.)		
1956	1721 Eye St., N.W.	2 yrs., 7 mos.)	61,781.80	
1956	1723 Eye St., N.W.	2 yrs., 7 mos.)		
1956	O'Shea Farm (Maryland)	2 yrs., 6 mos.	59,414.31	
1956	1610 K St., N.W.	10 yrs., 7 mos.	39,619.11	
1956	Madison Alley Garage	1 yr., 3 mos.	9,265.02	
1957	1105 D St., S.W. (Note: claimed to be sold under threat of condemnation, see Findings).	12 yrs., 6 mos.	23,287.09	
1957	404-14 6th St., N.W. (Sold at less than fair market value to Georgetown University and reacquired in a subsequent year, see Findings)	2 yrs.	75,548.33	
1957	Holmes Bakery (But see Findings).	2 yrs., 4½ mos.	883,417.70	
1958	Adams Property	3 yrs., 4 mos.	164,088.65	(deferred profit as of 12/31/58)
1959	1620 Wilson Blvd., Arlington, Va.	13 yrs., 1 mo.	17,902.69	
1960	301 Broad St., Falls Church, Va.	2 yrs., 3 mos.	19,608.91	
1960	38 Myrtle St., N.E.	10 yrs., 1 mo.	2,757.03	
1960	[illegible]	[illegible]	[illegible]	

The property described as "1105 D St., S.W." was acquired by Murray in 1944. It was later designated as being in an area intended by the District of Columbia Redevelopment Land Agency for an urban renewal or slum clearance project. Condemnation of the property for such project was authorized on December 5, 1956, and it was sold to the Agency pursuant to threat of condemnation in 1957. The property described as "38 Myrtle St., N.E." was sold to the same Agency. The condemnation of such property was authorized in 1959 and it was sold to the Agency pursuant to threat of condemnation in 1960. The property described as "College Park Airport (part)" was sold by Murray pursuant to a threat of condemnation authorized in 1959. A more detailed statement of facts concerning these properties and their ultimate sales is set out *infra*.

The property located at 1919-25 M St., N.W., was acquired by Murray for the specific purpose of erecting thereon a building to be leased to the Royal Typewriter Co., which was dissatisfied with the premises occupied by it at 1105 D St., S.W., under lease from Murray and referred to hereafter in connection with sales under threat of condemnation. The M Street property was sold by Murray when the Royal Typewriter Co. failed to enter into a contract to lease the proposed building.

The proceeds received by Murray from the sale of the O'Shea Farm in 1956, which appears in the above schedule, were paid to the Internal Revenue Service in partial satisfaction of a lien placed on the property in connection with the collection of income taxes owed by Murray.

Murray's personal income tax returns and the tax returns of various joint ventures show that the following

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sales of real estate were made by joint ventures of which Murray was a member:

Year	Location	Murray's Profit (or Loss)	Holding Period
1950	Weaver Terrace (part)	$ 6,535.90	4 yrs.
1951	472 L St., N.W.	23,726.86	6 yrs., 9 mos.
1951	1623-1625 L St., N.W.	41,498.39	6 yrs., 11 mos. (Shown by Exhibits 187 and 196)
1953	Dupont Circle Building (Note: Reported by Murray in 1954)	454,442.25	See Findings *infra* Approximately 10 yrs.
1954	3127 12th St., N.E.	3,023.97	
1954	1514 L St., N.W. (Note: Reported by Murray in 1955)	152,883.89	2 yrs., 3 mos.
1955	Weaver Terrace (part)	9,798.09	(9 yrs., 2 mos.—1 part) (9 yrs., 10 mos.—1 part)
1956	Berry Option (See Findings)	77,000.00	1 yr. (correct period) 9 mos.)
1957	Weaver Terrace (part)	13,050.48	12 yrs., 1 mo.
1957	Kent	2,347.81	11 yrs., 4 mos.
1957	MacArthur Blvd.	16,492.94	11 yrs., 3 mos.

Income tax returns of Stewart's Corner, Inc., disclose the following sales by the corporation of real estate or interests therein:

Year	Description	Sales Price	Profit (or Loss)
F.Y. 1956	25th St., N.W.	$ 60,000.00	$ 4,995.00
F.Y. 1956	9th and F Sts., N.W.	177,000.00	37,811.94
F.Y. 1956	605 F St., N.W. (Option)	5,500.00	4,500.00
F.Y. 1957	1612 K St., N.W.	140,000.00	7,626.64
F.Y. 1957	510 2nd St. and		
F.Y. 1957	509-13 3rd St., N.W.	101,750.00	26,365.83
F.Y. 1958	615 2nd St., N.W.	16,440.00	6,719.50
F.Y. 1958	301 F St., N.W.	Not shown	500.00
F.Y. 1958	617 2nd St., N.W.	18,000.00	7,934.44
F.Y. 1958	Rear 127-129 F St., N.W.	27,000.00	11,946.38
F.Y. 1958	129 F St., N.W.	22,840.00	14,771.07
F.Y. 1960	1731 Moore St., Arlington, Va.	68,000.00	17,587.67
F.Y. 1961	2300 Rhode Island Ave., N.E.	37,000.00	1,633.64
F.Y. 1961	Wheaton Gas Station	231,458.37	50,682.07

The following schedule shows the properties owned by Murray as of April 30, 1964, the date each property or part thereof was acquired, and the cost of such acquisitions according to Murray's books:

Description of Property	Date Acquired	Cost according to Murray's Books
6th and D Streets, N.W.		
Sq. 457, Lot 800 400 - 6th St., N.W.	2/1/43	$76,550.00
Sq. 457, Lot 857 611 D N.W.	6/4/47	15,133.35
Sq. 457, Lot 803 612 D N.W.	7/8/47	12,130.32
[1](Sq. 457, Lot 843 & 844 (408 - 6th St., N.W. (	1/27/55	60,282.50
[1](Sq. 457, Lot 856 (406 - 6th St., N.W.	1/27/55	
Sq. 457, Lot (854-851) 841 412 - 6th St., N.W.	1/4/55	25,127.00
Sq. 457, Lot 842 410 - 6th St., N.W.	4/26/55	50,194.00
Sq. 457, Lot 27 615 D St., N.W.	8/1/55	40,163.50
Sq. 457, Lot 38 617 D St., N.W.	6/27/55	38,163.50

[1] There is a discrepancy unexplained by the records between the addresses and lot numbers appearing here and those used by Murray and Georgetown University in their conveyances later described herein. This discrepancy, however, appears to be immaterial to any issue herein.

Description of Property	Date Acquired	Cost according to Murray's Books
Sq. 457, Lot (4) C 623 D St., N.W.	6/20/55	50,208.00
Sq. 457, Lot (4) A & B 619 D St., N.W.	6/10/55	116,864.50
Sq. 457, Lot 840 414 - 6th St., N.W.	9/28/56	53,243.25
Sq. 457, Lot 845 404 - 6th St., N.W.	8/13/56	50,234.50
Sq. 457, Lots 33 & 35 Rear 619-623 D St., N.W.	5/1/59	95,356.00
46th & Blain Sts., N.E.		
Sq. 5137, Lot 36 & 37	8/13/40	600.00
18th & Newton Sts., N.E.		
(a) Sq. 4147, L. 39, 46, 47, 48, 49	7/29/52	99,993.80
(b) Sq. 4147, L. 19 3512 - 18th St., N.E.	9/10/57	10,097.50
Dixie Airport		
Rt. 450 & 301, Md.	6/4/52	3,265.01
Parole & West Streets		
Annapolis	11/24/53	5,490.20
4130 - 4th St., S.E.		
Sq. 6165, L. 58	6/14/52	42,394.09
7200-14 New Hampshire Takoma Pk., Md.		
Bl. 7, Wildwood Sec. 2, L. 3-P2-p.4	7/22/52	71,311.50

Description of Property	Date Acquired	Cost according to Murray's Books
Bl. 7, Wildwood Sec. 2, L 6-P7 - P5	8/3/53	30,321.87
Bl. 7, Wildwood Sec. 2, L.P.4-P.5	7/15/53	50,536.90
College Park Airport		
1/6 Prop.	6/4/52	13,400.00
5/6 Bought	1/13/54	119,661.00
(This property contained 154 acres. Approximately 89 acres were sold in 1960).		
1112 First St. Alexandria, Va.		
In Holmes Settlement	6/1/55	151,263.00
7th & E Sts., N.W.		
Sq. 456, L. 35	7/5/55	601,224.50
Sq. 456, L. 809	7/12/55	98,274.00
West St. Extended,		
Annapolis	1/5/54	14,130.39
Viers Mill & Ga. Ave.		
Montgomery Co., Md.	3/30/61	231,458.37
4th St., N.W.		
(Bet. G & H)	1962	175,440.00
Jewell Cottage, Annapolis		
Wild Rose Shore, Ann Arundel Co., Md.	1962	22,500.00
Oxon Hill, Md.	1963	40,246.00
(Originally acquired by Stewart's Corner in 1956).		

The income tax returns of Stewart's Corner, Inc., disclose that it owned, in addition to the items sold by it as detailed above, the following real estate or interests therein:

Location	Cost of Land	Cost of Building
727-29 4th St., N.W.	$26,634.50	
731-33 4th St., N.W.	30,136.25	
304 H St., N.W.	23,674.50	
Ardmore Farms	25,179.50	
101 E St., N.W.	5,358.04	$ 4,242.06
400 Eye St.	3,931.03	2,068.97
201-5 E St., N.W.	44,405.37	45,606.13
501-9 G St., N.W.	15,383.04	14,767.96

Petitioners' income tax returns disclose the receipt of the following gross and net rentals (petitioner Grace Murray's rentals are designated by (W):

Year	Gross Rentals	Net Rentals
1948	$59,118.01	$15,564.49
	27,677.50(W)	13,044.88 (W)
1949	57,560.47	10,694.46
	30,216.64(W)	17,003.59 (W)
1950	63,645.67	20,484.85
	32,875.39(W)	19,572.14 (W)
1951	68,056.07	24,659.29
	32,876.33(W)	19,260.84 (W)
1952	71,981.41	22,222.37
	32,887.51(W)	19,268.38 (W)
1953	66,915.85	(935.48)Loss
	29,937.14(W)	17,397.71 (W)
1954	83,173.35	(13,744.87)Loss
	35,987.83(W)	22,426.24 (W)
1955	118,346.60	1,782.49
	Not shown	7,817.92 (W)
1956	123,892.11	(188,776.14)Loss
	2,751.62(W)	(15,684.98)Loss (W)

Year	Gross Rentals	Net Rentals
1957	[1] 123,670.89	[1] (123,966.92) Loss
1958	[1] 163,185.79	[1] (42,760.75) Loss
1959	[1] 212,353.94	[1] 10,680.33
1960	[1] 209,248.03	[1] (18,623.27) Loss
1961	[1] 213,316.32	[1] 11,783.83
1962	207,350.07	1,508.46
1963	[1] 193,829.58	[1] 36,422.83

[1] Includes rentals received by Grace Murray.

The income tax returns of Stewart's Corner, Inc., disclose that it received rental income from properties owned by it as follows:

Year	Gross Rentals	Net Rentals
F.Y. 1959	$24,459.38	($1,165.21)
F.Y. 1960	26,251.60	(7,505.73)
F.Y. 1961	27,691.41	(950.06)
F.Y. 1963	6,257.50	43.33

Petitioners' income tax returns disclose the receipt by them of interest income as follows:

1950	$3,345.05
1951	2,398.47
1952	2,179.49
1953	3,724.54
1954	19,583.70
1955	30,275.21
1956	20,225.54
1957	15,435.60
1958	11,390.50
1959	30,270.43
1960	24,711.85
1961	24,712.05
1962	129,767.27
1963	102,175.09

Petitioners' income tax returns disclose deductions on account of demolition expense and losses on abandonment of improvements as follows:

Year	Demolition Expenses	Losses on Abandonment
1953	——	$ 31,810.89
1954	$ 3,718.34	——
1955	6,808.70	151,950.16
1956	12,848.88	125,553.52
1957	18,299.94 (including $16,831.09 taken on Holmes Bakery property)	364,337.58 (taken on Holmes Bakery property)
1958	——	3,810.85 (plus $2,190.68 fire loss)
1960	——	341.36
1962	915.00	190,569.22
1963	8,954.25	27,516.21

In June 1946 Murray acquired stock in Ducirco, Inc., which owned Washington real estate known as the Dupont Circle Building. On April 30, 1952, the corporation was dissolved and its assets were distributed to Murray and J. Daniel Weitzman who owned all of its stock. In Murray's 1952 income tax return he reported net capital gains resulting from such distribution in the amount of $246,725.75. After the distribution in liquidation, Murray and Weitzman owned and operated the property as a joint venture known as Ducirco Company. In 1953 Murray and Weitzman sold the property (including the building, furniture, and equipment) for the net amount of $1,208,884.49, of which $600,000 was represented by notes. In his return for 1954 Murray reported capital gains from this transaction in the amount of $454,442.25, representing one-half of $1,208,884.49 less $150,000 on account of the discounted value placed by Murray on the notes received by the joint venture.

Three contiguous properties, known as Weaver Terrace, Kent, and MacArthur Boulevard, were acquired piecemeal by Murray in joint ventures with Weitzman in 1945 and

1946. Prior to 1957 the joint venturers sold two tracts from the property designated as Weaver Terrace, one in 1950 and the other in 1955. Murray's gains from such sales were reported in his returns for those years as long-term capital gains. There was a building of some kind on the MacArthur Boulevard property upon which depreciation was taken until it was demolished in 1954. Rents of $1,440 were received from this property in 1948 and 1949. The net rental income from this property was $582.94 for 1948 and a net loss of $1,115.61 was sustained from this property in 1949. No other income was reported as being received from this property. Other than these rentals from the MacArthur Boulevard property, petitioner received no income from the property held by the joint ventures except the gains of $6,535.90 resulting from the sale in 1950 of a parcel of these properties and of $9,798.09 resulting from the sale in 1955 of another parcel. For all the years during which these properties were held by the joint ventures expenditures for taxes and interest were made by petitioner and Wetizman. In 1957 the remaining properties of these three joint ventures were sold for prices which exceeded the bases of Murray and Weitzman by $63,782.46. In his income tax return for 1957 Murray reported the receipt of $31,891.23 (representing one-half of $63,782.46) as long-term capital gains.

On various occasions Murray has used his corporation, Stewart's Corner, and other individuals as straw parties in acquiring real estate. All transactions carried out by Murray in the names of straw parties have been reflected in Murray's books and records.

On or about March 14, 1956, the president of the First National Bank called a conference with Murray to induce him to sell some of his real estate holdings in order to reduce his indebtedness to the bank. Murray owed the bank approximately $179,000 at that time. The bank was concerned about Murray's account when it became aware

of some outstanding tax liens against Murray's property and of an action brought against Murray by the former owners of Holmes Bakery. On or about August 24, 1956, Murray reduced his indebtedness to the bank in the approximate amount of $83,000.

On or about April 23, 1956, Murray obtained a personal loan of $224,000 from the National Mortgage and Investment Corporation in order to pay a judgment obtained against him. Murray and his wife gave a note for the loan secured by a blanket deed of trust on several of Murray's pieces of real estate and on several lots located on Sixth Street, N.W., in Washington, D. C., titles to which were in the name of Stewart's Corner.

On April 5, 1956, Murray paid to the district director of internal revenue $116,156.23 in payment of taxes and interest due from Murray for the year 1954, and for release of the lien on his property. For the year 1956 Murray paid income taxes and interest in the approximate amount of $158,000.

Respondent's agents examined and audited petitioner's income tax returns for the years 1955, 1956, and 1957, and proposed no material changes in the tax treatment of the gains from the disposition by petitioner of his interests in the Gordon Tract and from the sale of the Berry Option as reported by him in his returns for those years. By a Notice of Adjustment covering the year 1955 (Treasury Department Form 1331) signed on behalf of respondent by the District Director at Baltimore pursuant to a delegation of authority, refund was allowed to petitioner for that year in the amount of $556.43 together with interest thereon.*

During the years here in issue Murray was an investor in real estate (or interests therein) and was also engaged

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* As revised by Order of July 1, 1965; *infra*, p. 78.

in the business of buying and selling real estate (or interests therein). He held some of his real property as an investment and some of his real property (or interests therein) primarily for sale to customers in the ordinary course of his trade or business as a dealer in real estate.

Gordon Tract

On December 8, 1952, Murray entered into a contract to purchase approximately 500 acres owned by the Estate of Fulton R. Gordon, located in the Oxon Hill District, Prince Georges County, Maryland. The tract will sometimes hereinafter be referred to as the Gordon Tract and the sellers the Gordon heirs. The total purchase price was $2,000 per acre, or approximately one million dollars. Murray gave a deposit of $30,000 at the time he entered into the contract and he agreed to pay $100,000 cash at the date of conveyance on which the $30,000 deposit was to be credited. The sellers agreed to take back a first deed of trust securing the balance due, which was payable on or before 7 years from the date of settlement, bearing interest at the rate of 3 percent per year. Murray agreed to secure a survey of the property at his own expense. The sellers agreed to pay the real estate broker, Dorothy K. Winston, the commission due to her. The contract provided that 30 acres designated therein and later changed were to be released from "the deferred mortgage" (evidently created by first deed of trust) at the time of settlement.

In the contract it was also provided that the remaining acreage should be released from the deferred mortgage at ten cents a square foot as future payments were made. The contract was amended, for the benefit of the Gordon heirs, to provide that the ground was to be "released from the defferred [sic] mortgage at Twenty Cents (20¢) a square foot to a depth of 400 feet for ground fronting on the paved roads surrounding the ground and all other

ground to be released at the rate of Ten (10¢) per square foot."

Murray's wife did not sign the contract to purchase the Gordon Tract or the subsequent assignment thereof.

Settlement was delayed on the contract of December 8, 1952, because it took approximately 1 year to survey the property and because of several defects in the Gordon heirs' title to the property. A portion of the Gordon Tract (containing approximately 30 acres) which the Gordon heirs proposed to sell to Murray, was owned by William V. James. This tract located within the Gordon Tract will sometimes hereinafter be referred to as the James Tract. Murray was eventually able to clear this defect by purchasing on or about January 26, 1954, from William V. James the property he owned for $55,000 which it was agreed should be credited on the $100,000 payable to the Gordon heirs on the date of conveyance. It was also agreed that the James Tract should be covered by the first deed of trust securing the balance of the purchase price payable to the Gordon heirs. On January 25, 1954, the Gordon heirs delivered a quit claim deed to James who immediately transferred all of his interest in the property to Murray. There were other small parcels within the Gordon Tract to which the Gordon heirs did not have good title. In order to perfect title to the entire tract, Murray acquired these parcels from those claiming title thereto as follows:

One parcel (the Gillespie land) was purchased by and conveyed to Murray on or about April 2, 1954. Another parcel (the Gulick land) was purchased by and conveyed to Murray on or about March 24, 1954. Another parcel (the Ford land) was purchased by and conveyed to Murray on or about June 7, 1954. Another parcel (the Clay land) was purchased by and conveyed to Murray on or about April 7, 1954. Another parcel (the Perrygo land) was purchased by and conveyed to Murray on or about May 12,

1953. On May 20, 1954, he also entered into a contract to purchase approximately 3 acres in the so-called Gordon Tract from George M. Berry and Ernest L. Pimm for $8,250.

Murray also acquired title to 30 acres contiguous to the Gordon Tract from Indian Head Heights, Inc., a corporation wholly owned by Murray.

Dorothy K. Winston advised the Gordon heirs that settlement on the contract would take place on March 17, 1954, although at this time the title of the property had not been cleared. Murray refused to take less than good title to the entire tract. In addition to the objections to the title of the Gordon Tract cleared up by the acquisition by Murray of the parcels detailed above, there were certain Federal tax liens on the property which had been discharged prior to January 1, 1955.

Sometime in 1954 Dorothy K. Winston, a real estate broker, introduced to Murray the Romano brothers who had previously built homes on Long Island, New York. The Romano brothers were owners of a New York corporation known as Mar-Dill Holding Corp., sometimes hereinafter referred to as Mar-Dill. Mar-Dill was interested in acquiring land in the Washington, D. C., area for the construction of a housing development. Dorothy K. Winston showed the owners of Mar-Dill several pieces of property including the Gordon Tract. Mar-Dill was interested, at first, in acquiring only 30 acres with an option to purchase or lease the balance of the land at a sale price of $4,000 per acre. On December 2, 1954, Mar-Dill gave Murray $5,000 as a deposit. In January or February 1955 representatives of Mar-Dill indicated to Murray that they would purchase his contract* to purchase the entire Gordon Tract.

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* As corrected pursuant to Order dated July 1, 1965; *infra*, p. 78.

In negotiating with the representatives of Mar-Dill, Murray's accountant indicated that he did not want Murray to enter into an executory agreement to sell to Mar-Dill the James Tract and the contracts* to buy the Gordon Tract and contiguous properties. The owners of Mar-Dill, however, refused to go through with the deal without a signed contract. An impasse was reached and Murray yielded. The agreement between the parties was reduced to writing. Since the principal asset to be acquired by Mar-Dill from Murray was the contract right to purchase the Gordon Tract, it did not require the signature of Murray's wife to the agreement.

Mar-Dill and Murray made settlement on this contract on or about March 3, 1955, as of March 5, 1955. Murray assigned to Mar-Dill his contract of December 8, 1952, to purchase the Gordon Tract, upon which contract there was still due a $10,000 cash payment and the obligation of executing a note secured by deed of trust for $886,384.60, together with his real estate contract with Berry upon which there was $7,750 still due. On March 2, 1955, Murray and his wife conveyed to Mar-Dill the several parcels he acquired in clearing up the title to the Gordon Tract, together with approximately 2 acres of the land acquired from Indian Head Heights, Inc. In consideration for all of the foregoing, Mar-Dill agreed to and did pay to Murray $2,095,865.40 as follows: $17,050 by check, $85,200 by note payable in 3 years with 4 percent interest, secured by a deed of trust on land which was released by the Gordon heirs, and $1,993,615.40 by note which bore no interest, secured by a deed of trust covering the property subordinate in certain respects to a deed of trust securing the payment by Mar-Dill of $886,384.60 to the Gordon heirs.

Murray's profit on the entire transaction was $1,890,311.98 which he reported on his 1955 return, under the installment method, as long-term capital gain.

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* As corrected pursuant to Order dated July 1, 1965; *infra*, p. 78.

Mar-Dill purchased the property primarily for the purpose of erecting one-family dwelling houses thereon and also for the purpose of utilizing portions of the property for the erection of commercial buildings. The representatives of Mar-Dill negotiated directly with the Gordon heirs and succeeded in having them agree to include the 30 acres comprising the James Tract in the deed of trust to be given to them in lieu of the 30 acres designated to be released from the mortgage in the contract between the Gordon heirs and Murray. Mar-Dill arranged with the Gordon heirs for a section of the tract to be released from the deed of trust so that it could begin construction of houses on a tract free of any encumbrances. Ultimately, the Gordon heirs arranged for Mar-Dill to take possession of the property.

Murray acquired and held the contract to purchase the Gordon Tract and acquired and held the properties contiguous thereto, together with the contract to purchase the Pimm-Berry land, primarily for sale to customers in the regular course of his business as a real estate dealer.

The gain on the installment collections received by Murray in 1957 and 1961 from the sale of his contract to purchase the Gordon Tract and from the sale of properties contiguous thereto constituted ordinary income to Murray in such years.

Holmes Bakery

In the summer of 1954 Murray explored the possibility of purchasing Holmes & Son, Incorporated, a bakery in Washington, D. C., sometimes hereinafter referred to as Holmes Bakery. Murray believed that the bakery business was a "basic" business and therefore had a depression-proof factor. Also, in view of the potential growth in Washington, D. C., Murray believed that the Holmes Bakery had a potential growth. For these reasons, he was interested in purchasing the Holmes Bakery to provide a business for his sons to operate. Several conferences were held

between Murray as prospective buyer and an officer of Holmes Bakery.

During the Labor Day weekend of 1954 Murray's oldest son, who was to have been an active participant in the business, was killed in an automobile accident. Negotiations between Murray and the representatives of Holmes Bakery were then broken off, and were not resumed until approximately January 1955. The negotiations were carried on with the representatives of Holmes Bakery by Murray himself, his accountant, and his attorney. At that time Murray contemplated that the bakery business, if and when acquired, would eventually be operated under the management of his son-in-law, Althoff. On or about January 27, 1955, the negotiations were concluded upon a basis satisfactory to both sides.

It was determined that the assets of the Holmes Bakery would be turned over to Murray on May 28, 1955. This date was chosen because it gave Murray and his representatives time in which to become familiar with Holmes' operation, and because May 28, 1955, was a 3-day weekend which made it a convenient time to take an inventory which was part of the process in effecting the change in ownership. At the time Murray negotiated for the purchase of the assets of the Holmes Bakery it was his intention to continue its operation. Holmes Bakery had approximately 400 employees prior to the purchase of its assets by Murray. All of them, including department heads and executives, through the lowest-paid unskilled workers, were assured that the change in ownership did not mean they would lose their jobs. They were informed that Murray intended to enlarge the operation, and therefore the change in ownership was to their advantage. Murray's son-in-law, Althoff, was trained as a replacement for Paul K. Corcoran, the general manager of Holmes Bakery, who agreed to stay on if necessary as a consultant but only for a limited time. Althoff spent a considerable amount of time, both day and

night, at Holmes Bakery, after the negotiations were concluded in January 1955 for the purpose of familiarizing himself with the bakery business.

On or about May 2, 1955, Murray advised Corcoran of his conclusion that the operation of Holmes Bakery was too complex for him to become deeply involved in. Murray had made arrangements sometime prior to May 2, 1955, to sell the route business and the personalty of Holmes Bakery to one of its competitors, General Baking Company. Murray's decision not to continue the operation of Holmes Bakery himself was made after he found that the operation of the business required many hours of work, was very complex, and because he did "not want the headache of operating a bakery—a business which entails work of 160 hours a week.

The agreement reached between Murray and Holmes Bakery in January 1955 was given final form by three separate contracts, all dated May 31, 1955. These contracts were executed at the suggestion of the general counsel of Holmes Bakery because of his opinion that it would be to its advantage taxwise, and this suggestion was concurred in by Murray's accountant. One of the reasons why Murray agreed to the execution of the three contracts was that it would facilitate the sale of the operating assets by him to the General Baking Company.

One contract covered the bakery operations and called for the transfer to Murray of certain personal property, including the trademarks, goodwill, inventory, rolling stock, and route balances. Murray agreed to pay $360,000 in cash for these assets. Another contract was for the sale of real estate and buildings thereon in Washington, D. C., which comprised the plant of Holmes Bakery, and also real estate and a warehouse thereon in Alexandria, Virginia, which was used by Holmes as a subdepot and loading station. For these items Murray agreed to pay $1,100,000.

Payment was to be made by 100 serial promissory notes signed by Murray in the principal amount of $11,000 each.

The third contract was a lease agreement covering property known as the Holmes Tract in Rosslyn, Arlington County, Virginia. The term of the lease was 25 years and Murray agreed to pay rent in the amount of $25,000 per year. The lease also provided for an option for Murray to purchase the premises at any time after January 1, 1956. The properties described in the three separate agreements constituted all of the operating assets of Holmes Bakery.

At a meeting during the weekend of May 28, 1955, Holmes Bakery transferred to Murray the trademarks, inventory, rolling stock, and route balances in consideration for $360,000 from Murray. At the same meeting Murray conveyed these items to the General Baking Company. Part of the payment given by Murray to Holmes Bakery Company consisted of a check for approximately $207,000 from General Baking Company payable to Murray and endorsed by him to the order of Holmes Bakery. At the same time General Baking Company also gave Murray a check for approximately $100,000. On or about the same date Murray entered into possession of the real estate of Holmes Bakery and leased its bakery building to General Baking Company for the period May 28, 1955, to December 31, 1955, for $1,650 a month, with the right in General Baking Company to terminate the lease at the end of any calendar month on 15 days' notice.

Murray and the representatives of Holmes Bakery met on June 7, 1955, for the purpose of making final settlement pursuant to the contracts. On that date Murray signed the notes and deeds of trust created in connection with the transaction. However, a dispute arose with regard to the payment of certain money held in escrow by the title company, Murray insisting that certain concessions be

made to him pending the clearing of title to a small strip of the Holmes property. In July 1955 Holmes brought an action for specific performance against Murray which resulted in a decree on April 11, 1956, favorable to the plaintiff but modifying the deed of trust to permit Murray to demolish the bakery building.

Contiguous to the plant of Holmes Bakery in Washington, D. C., and located on its property were residences occupied by employees who had been with Holmes Bakery for many years. The residences were old and in poor condition in 1955 and were no longer occupied by key personnel. In a discussion involving the future operation of the Holmes Bakery by Murray between Corcoran and Murray it was determined that these residences should be razed to provide additional operating space for the bakery. Corcoran believed this action should have been taken many years prior to 1955, and that the time of change in ownership of Holmes Bakery was an appropriate time to dispossess the tenants in these residences. Accordingly, on or about May 17, 1955, notices were sent to all of such tenants to vacate the premises.

Holmes Bakery ceased production on May 27, 1955. On that night the first piece of equipment, a wrapping machine, was moved from Holmes Bakery to the plant of the General Baking Company.

The insurance coverage on the Holmes Bakery Building in the total amount of $500,000, in effect when Murray acquired the Holmes Bakery, was maintained by Murray for a period of approximately 1 year after he acquired the property.

The bakers' unions in Washington, D. C., to which the baking employees of Holmes and the General Baking Company belonged, required that bakery products sold in Washington, D. C., could not be shipped in from other cities, unless the unions gave their permission. General Baking

Company obtained such union permission to make some of the products at Richmond, Virginia, and Philadelphia, Pennsylvania, previously made by Holmes Bakery in its Washington plant. Therefore, the General Baking Company cancelled its lease after a short period of time. Thereafter, Murray attempted to lease the premises to others.

One of the parties whom Murray interested in acquiring the buildings and baking facilities of Holmes Bakery was Ottenberg Bakeries. Ottenberg Bakeries, which operated two separate baking facilities, indicated an interest in consolidating its two operations by using the facilities and buildings available at Holmes Bakery. This plan did not materialize.

On July 7, 1956, Murray listed for rent the Holmes Bakery Building with a Washington, D. C., broker. The rental price of the property, consisting of approximately 80,000 square feet, was listed at "80 cents per square foot per year *as is.*"

Murray caused drawings to be prepared to convert the bakery building into a warehouse. He obtained, on or about April 16, 1957, a building permit from the District of Columbia to carry out the work called for in such drawing. A structural survey of the building was also made on or about April 15, 1957, to determine the strength of the members in the existing building, and to determine what work was necessary in order to make all parts of the building conform to District of Columbia specifications for warehouses. A revision of the plans was made on April 25, 1957, to provide a loading platform. At that time the negotiations concerning a lease to The Mayer Furniture Co., hereinafter referred to, were in progress. The survey indicated that extensive work would not have to be done to the building. The cost of the work was estimated by the architect to be approximately $3,000. The heating system, including most of the radiators and most of the electrical

fixtures, was still in place. Murray paid $800 for the architectural and engineering services rendered and $45 for the building permit.

There was a hole in the roof which was made to remove some of the heavy baking equipment in transferring it to the General Baking Company. Murray paid a contractor $1,125 for labor and material to have repairs made to the roof. The work was begun in February 1957. In March 1957 the contractor replaced some joists in the building and replaced some brick and cement. Murray paid $160 for the labor and materials on this job. The same contractor, in May 1957, submitted to Murray an estimate for other construction work on the building in the amount of $3,800.

In the early part of 1957 The Mayer Furniture Co. negotiated with Murray for the possible rental of the Holmes Bakery Building to be used as a warehouse. Negotiations extended over a period of several months. On or about April 23, 1957, The Mayer Furniture Co. proposed to lease the premises for 10 years subject to cancellation by it at the end of the third year. Rental was to be $42,000 per year for the first 2 years of the tenancy and $39,500 per year thereafter. The Mayer Furniture Co. required certain construction to be made which was estimated to cost approximately $87,000. No lease to The Mayer Furniture Co. was executed, and negotiations with it were terminated prior to May 23, 1957.

On May 23, 1957, Murray offered to lease the Holmes Bakery Building to the General Services Administration with repairs to include acoustical tiled ceiling, asphalt tiled floors, full air conditioning, fluorescent lighting, and all services to be furnished by lessor, for $245,000 per year. If the tenant serviced the building, the rental would be $157,500 per year. This offer to lease was not accepted. Shortly thereafter a real estate broker, acting on behalf of

Murray, also attempted unsuccessfully to rent the premises to the Government Printing Office.

After Murray failed to succeed in renting the Holmes Bakery Building to another bakery, to the Government, or to The Mayer Furniture Co. he determined it would be best to demolish the building and began the demolition about June 1, 1957, using his own employees.

On July 9, 1957, Murray entered into preliminary negotiations with Victor J. Orsinger, sometimes hereinafter referred to as Orsinger, for the sale of the Holmes Bakery premises. The proposed agreement drafted by Orsinger called for the following: "If any additional razing or demolition of structures on the premises is desired and requested by the grantees you [Murray] agree to accomplish same at actual cost." A second letter agreement from Orsinger written on July 16, 1957, which replaced the first letter, indicated that Orsinger was acting on behalf of the Society of the Divine Savior. This letter contained a clause which read: "If requested by the Society or its nominees, the property shall be delivered clear and free from any structures without cost to the Society or its nominees." It also contained the same clause relating to the demolition that appeared in the initial letter of July 9. The letter agreement of July 16 was signed by both Orsinger and Murray.

On July 24, 1957, Murray entered into a contract with the ABC Demolition Corporation to complete the demolition and removal of the Holmes Bakery Building and four of the houses in the same square block, all for the price of $18,000. The ABC Demolition Corporation began to work under this contract on July 29, 1957.

On July 25, 1957, Orsinger wrote again to Murray concerning the sale of the Holmes Bakery premises. He offered Murray advances to cover the cost of the demolition work which would be deducted from the payments due

to Murray. This letter was also signed by Orsinger and Murray.

On October 10, 1957, Murray entered into the final contract with Parkwood, Inc., of which Orsinger was the president, to sell to it all the land Murray owned in the square block in which the Holmes Bakery was located. This contract replaced and superseded the letters of July 9 and July 16. When Murray signed the final agreement to sell the land to Parkwood, Inc., the demolition work was not yet completed, and the contract provided that Murray would deliver the property in an "as is" condition except that all structures on the four largest parcels were to be removed by Murray. The October contract also referred to the advances Orsinger made to Murray in connection with the demolition expense. The demolition of the Holmes Bakery premises was not completed until early November.

The parties contemplated that Murray would complete the demolition work decided upon and started by Murray prior to his negotiations with Orsinger. Orsinger was only interested in buying the land. In order to dispose of the Holmes Bakery property to Parkwood, Inc., Murray acquired title to or contracted to purchase several lots, in his own name and in the name of Stewart's Corner, within the same square block because Parkwood, Inc., was interested in acquiring an entire city block. These lots were acquired on behalf of and using consideration furnished by Parkwood, Inc., and then conveyed without further consideration to Parkwood, Inc.

Murray did not hold the real estate formerly occupied by Holmes Bakery primarily for sale to customers in the ordinary course of his trade or business.

The Holmes Bakery property was not acquired with a view to demolition of the bakery buildings thereon situated. The demolition of these buildings was not motivated by the sale of such property to Parkwood, Inc.

Berry Option

Ralph D. Rocks, sometimes hereinafter referred to as Rocks, was and is the president of a construction company known as the Rocks Engineering Company. He also carried on the business of a real estate broker under the name of Allen & Rocks. Acting individually or through his corporation Rocks had constructed commercial buildings which he rented. He and Murray had had at least one business transaction with each other and were on friendly terms. At some time shortly prior to April 25, 1955, while they were playing hand ball, Rocks told Murray that he was considering the acquisition of an option to purchase some land near a commercial development of his in Prince Georges County, Maryland. He suggested to Murray that Murray join with him in acquiring the property, subdividing it, and arranging for either Rocks Engineering Company or another building company to improve the lots with low-cost housing and sell them, with Rocks and Murray retaining redeemable ground rents permitted under the laws of Maryland which would be equivalent to approximately 6 percent per annum on the amount at which the ground rents could be redeemed by the purchasers of the improved lots.[1] Murray agreed to join Rocks in the project and to furnish 50 percent of the money required for the acquisition of the property.

On or about April 25, 1955, in consideration of $1,000, Rocks obtained a 1-year option to purchase approximately 73 acres in Prince Georges County, Maryland, at a price of $2,533 per acre. The option was renewable for an additional year upon the payment of an additional sum of $2,000. The owners of the property were Heath and Sara Berry and the option to purchase this tract will sometimes hereinafter be referred to as the Berry Option.

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[1] For a description of Maryland ground rents see *Welsh Homes, Inc.*, 32 T.C. 239.

Murray had a 50 percent interest in the option and he paid 50 percent of the option price. He did not sign the option to purchase the tract because he was not present at the time the option was executed.

Murray and Rocks contemplated that after the exercise of the option the land would be subdivided, that approximately 300 houses would be built thereon, that the improved lots would be sold, that prior to such sales the improved lots would be leased to a straw corporation for 99 years renewable forever calling for the annual payment of an amount equal to 6 percent of the valuation of the lots by the sellers, but redeemable after 5 years at a figure representing such valuation capitalized at 6 percent, and that the leases (creating the so-called ground rents) would be assigned to the ultimate purchasers of the improved lots who thereupon had the obligation of paying the ground rents and the privilege of redeeming them. The option agreement provided that houses constructed on that part of the land facing a house located on a tract retained by the Berrys should front toward such tract, that the grantors of the option agreed to join and assist, without expense to them, in subdividing and rezoning the land, and that a purchase money deed of trust to be given to the Berrys by the holder of the option upon its exercise should be subordinated to any first deed of trust secured for construction purposes. Murray and Rocks were unable to go through with their original plans for the land because the Veterans Administration stopped insuring mortgages on houses located on leased land, and a loan secured by a mortgage insured by the Federal Housing Administration, which required the purchaser to pay 10 percent down, was not feasible because the builder would not be able to sell the houses with such a down payment required.

Vincent H. Dangler, sometimes hereinafter referred to as Dangler, was a builder of houses on Long Island, New York. He came to Washington at the invitation of the

Romano brothers to see their proposed housing development on the Gordon Tract, and became interested in the possible profits to be derived from a housing project in the Washington area. Dangler was led to Rocks' real estate firm by an advertisement in the newspaper, and he was taken to see several tracts of real estate including the land covered by the Berry Option. Thereafter, Dangler and his partner Siderine, met on several occasions with Murray and Rocks. On January 18, 1956, Dangler and Siderine entered into a contract with Murray and Rocks to pay $155,000 for the Berry Option, to be paid by $5,000 in cash and by the execution of a promissory note in the principal amount of $150,000 payable in 2 years with interest at 6 percent per year, secured by a deed of trust on the property. The note was executed in accordance with the terms of the agreement by a corporation formed by the assignees, known as Pepper Mill Village, Inc. On May 4, 1956, the Berrys conveyed by deed the land under option to Pepper Mill Village, Inc. Although Pepper Mill Village, Inc., was not successful and ultimately went bankrupt, the note for $150,000 was paid at a slight discount to Murray and Rocks by installments in 1956, 1957, and 1959, who divided the proceeds therefrom equally.

Murray entered into tentative agreements with Rocks to acquire options on tracts of land adjacent to the Berry Option, but only one of these tracts was acquired by them upon which they intended to eventually build an apartment house to hold for rental income. This property has been rented for several years as a farm.

At the time of its sale, Murray held the Berry Option primarily for sale to customers in the ordinary course of his trade or business.

The gain on the installment payments received by Murray in 1957 and 1959 constituted ordinary income to him.

Georgetown University

On or about December 12, 1956, Georgetown University proposed to purchase from Murray the following properties in Washington, D. C., acquired by or for him on the following dates at the following prices:

Description of Property	Date of Acquisition	Price
404 Sixth Street, N.W., Lot 845	8/13/56	$ 50,238.35
406 Sixth Street, N.W., Lot 844 } 408 Sixth Street, N.W., Lot 843 }	1/27/55	60,282.50
410 Sixth Street, N.W., Lot 842	4/26/55	50,264.68
412 Sixth Street, N.W., Lot 841	1/ 4/55	25,207.23
[1] 414 Sixth Street, N.W., Lot 840	9/28/56	55,521.69
	Total	$241,514.45

[1] Title to this lot was held by Stewart's Corner as a "straw man" for Murray.

These prices were approximately the same as the original cost to Murray of these properties as shown by Murray's books.

Georgetown University also proposed to pay for the costs of demolishing the buildings on some of the lots at a total cost of $10,559.72, an agent's fee to one Joseph Murray* in the amount of $8,000, and $1,500 representing one-half of certain other costs. Georgetown University was interested in acquiring the land for ultimate use in the expansion of its law center. It was successful in persuading Murray to accept its proposal because of his interest in Georgetown University, and it paid Murray by check the sum of $261,574.17 on or about January 3, 1957, to carry the transaction to completion. The prices which Georgetown University paid for the land were less than the fair market value of the land. In his income tax return for 1957 Murray reported that he had made a charitable gift in that year of $155,450.83, the amount by which the fair market value of this land exceeded the price

* As corrected pursuant to Order dated July 1,1965; *infra*, p. 79.

paid therefor by Georgetown. However, because of statutory percentage limitations (his adjusted gross income as reported for that year was $719.23) he took no deduction on account thereof. Respondent's adjustments resulted in a much larger figure for adjusted gross income in that year, and consequently respondent in his determination of deficiency for that year has allowed a deduction of the charitable gift as reported by petitioner.

Stewart's Corner had been used by Murray as a straw man in taking title to and executing a purchase money mortgage on one of the lots conveyed to Georgetown University. Stewart's Corner joined Murray and his wife in executing as grantors the deed by which all of the lots here in question were conveyed to Georgetown. The representatives of Georgetown University dealt only with Murray and not with Stewart's Corner.

While the prices received by Murray for these lots were approximately equal to his original costs, they were in excess of his bases as of the time of the sales to Georgetown. The parties agree that the amount of such excess was $75,548.33.[2] The cost to petitioner of lot 840 (known as 414 Sixth Street, N. W.) was $53,243.25. Depreciation taken by him on this property was in the amount of $415.80. His basis in this property at the time of its sale in 1957 was $52,827.45. The cost to petitioner of lot 845 (known as 404 Sixth Street, N. W.) was $50,234.50. Depreciation taken by him on this property was $344.61. His basis in this property at the time of its sale in 1957 was $49,889.89.

At the time Murray sold the lots to Georgetown he was promised the opportunity, if the University did not use the lots for educational purposes, to repurchase them at

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[2] It appears from Murray's income tax returns that a large part of this difference is due to depreciation and demolition losses deducted by Murray in 1955 and 1956.

approximately the same prices paid for them by Georgetown. Prior to December 1963 Georgetown decided to locate its law center at another site and in that month sold the lots back to Murray at prices which were approximately equal to Georgetown's bases therein.[3]

Murray's income tax return for 1955 reports the receipt in that year of gross rentals in the amount of $1,782.65 from "406-8-12 6th St." and net rentals therefrom as the loss figure ($1,924.35). His return for 1956 reports the receipt of gross rentals in the amount of $17,991.62 from "6th and D St. N. W."[4] and net rentals therefrom in the amount of $2,739.84.

At the time of the sale of 404 through 414 6th Street, N. W., to Georgetown University, all of the Sixth Street properties (except No. 414) were under a 1-year lease commencing October 1, 1956, at an annual rent of $33,000. The lease was renewable for two additional 2-year terms at annual rentals of $36,000 and $37,800, but was terminable by the lessor in case the property was sold to a party who would construct a building thereon.

After petitioner reacquired the property from Georgetown in December 1963 he continued to hold it and leased it for a term of 99 years at an annual rent of $100,000 for the first 2 years. The lease contains a provision whereby a minimum annual rent of $180,000 will be in effect beginning in 1966.

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[3] The deed by which these lots were reconveyed to Murray by Georgetown lists "lot 856" instead of "lot 844." However, it is apparent from the detailed description of "lot 856" that it is the same property as "lot 844." No point is made by the parties with regard to this discrepancy.

[4] Petitioner's books listed thirteen lots under the general description of "6th and D Streets, N.W." as owned by him in 1956. These included the six lots sold by him to Georgetown University in January 1957 and reacquired by him in 1963.

The lots sold by petitioner to Georgetown University in 1957 did not constitute property held by him primarily for sale to customers in the ordinary course of his business as a dealer in real estate. The gains realized by him from the sale of lots 840 and 845, known as 414 Sixth Street, N. W., and 404 Sixth Street, N. W., in the respective amounts of $2,694.24 and $348.46 constituted short-term capital gains and the gains realized by him from the sale of the other lots constitute long-term capital gains.

Involuntary Conversion of Properties

The property carried on the books of Murray as "College Park Airport" originally consisted of approximately 154 acres located in Maryland not far from Washington, D. C. A one-sixth interest in this property was owned by a corporation known as College Park Airport Corporation while various individuals owned the remaining five-sixths interest therein. Murray acquired the stock of the Airport Corporation in 1952 and in late 1953 he purchased the interests of the individual owners. Thereafter, the corporation was dissolved. Murray leased the property for use as an airport.

The Maryland-National Capital Park and Planning Commission determined at its meeting on November 25, 1959, to initiate condemnation proceedings to acquire a part of this property. On January 20, 1960, the Commission entered into a land purchase contract to purchase approximately 94 acres of the College Park Airport property from Murray and his wife for $90,000, payable in cash. Under the terms of the land purchase contract Murray retained the right to continue the possession of "[a]ll that portion of the land now used as air field runways * * * until ready to be developed by Vendee, when full possession will be given upon thirty days written notice." By reason of a modification of this contract resulting from a survey made subsequent to its execution, Murray conveyed approxi-

mately 89 acres to the Maryland-National Capital Park and Planning Commission in February 1960 for $85,318.68 under threat of condemnation.

In 1944 Murray acquired a building at 1105 D Street, S. W., in Washington, D. C., which he leased to the Royal Typewriter Company. This property was located in an area which was later designated by the District of Columbia Redevelopment Land Agency for an urban renewal or slum clearance project. Condemnation of this property for such project was authorized on December 5, 1956. Murray's property at 1105 D Street, S. W., Washington, D. C., was sold under threat of condemnation on March 26, 1957, for $74,600.

Murray's property at 38 Myrtle Street, N. E., Washington, D. C., a row brick house acquired by him in 1944 and rented by him as a residence, was sold on May 27, 1960, under threat of condemnation for $5,000 to the District of Columbia Redevelopment Land Agency. Authorization for such condemnation was given on September 25, 1959.

Murray purchased property at 617 D Street, N. W., on June 27, 1955, for $38,163.50; at 615 D Street, N. W., on July 20, 1955, for $40,163.50; and at 619-22 D Street, N. W., on May 1, 1959, for $95,356. These D Street properties included a store rented as a restaurant and a parking lot.

Petitioner took and was allowed deductions on account of the depreciation of all of these properties for the years in which he owned and used them.

In February 1960 petitioner made a payment of $49,200 on the mortgage covering the remaining 65 acres of airport property which he then owned (and still owns) and from which he received (and still receives) rental income.

Murray's income tax returns for the years 1948 through 1963 indicate the following rentals received from the three properties sold under threat of condemnation. The

legends (G) and (N) indicate gross and net rentals, respectively. Figures in parentheses indicate losses.

Year	11th and D Streets, S.W.	38 Myrtle Street, N.E.	College Park Airport
1948	$13,884.65 (G)	$366.00 (G)	—
	7,400.16 (N)	118.97 (N)	—
1949	11,043.80 (G)	366.00 (G)	—
	3,991.62 (N)	207.27 (N)	—
1950	11,400.00 (G)	366.00 (G)	—
	5,253.77 (N)	158.82 (N)	—
1951	12,971.46 (G)	366.00 (G)	—
	6,655.66 (N)	200.77 (N)	—
1952	12,317.92 (G)	366.00 (G)	—
	5,607.73 (N)	190.53 (N)	—
1953	12,000.00 (G)[1]	305.00 (G)	—
	6,118.12 (N)	154.48 (N)	—
1954	10,450.00 (G)	366.00 (G)	$3,250.00 (G)
	5,688.11 (N)	230.86 (N)	1,329.43 (N)
1955	11,400.00 (G)	366.00 (G)	3,000.00 (G)
	5,362.34 (N)	246.57 (N)	1,886.52 (N)
1956	11,400.00 (G)	152.50 (G)	3,875.00 (G)
	5,276.94 (N)	(37.05) (N)	(260.96) (N)
1957	1,900.00 (G)[2]	—	5,437.50 (G)
	2,498.78 (N)	—	23.42 (N)
1958			6,000.00 (G)
			3,366.73 (N)
1959			6,000.00 (G)
			(18.27) (N)
1960			5,500.00 (G)
			(2,758.90) (N)
1961			6,000.00 (G)
			4,381.78 (N)
1962			5,500.00 (G)
			3,816.99 (N)
1963			6,250.00 (G)
			3,809.00 (N)

[1] Includes rent received from "331 11th Street, S.W."

[2] Petitioners' return for 1957 shows deductible expenses as ($598.78) resulting from real estate taxes shown to be ($1,507.68). With no further explanation the figure $598.78 is added to the gross rental income of $1,900, resulting in the net figure of $2,498.78.

There is no dispute as to petitioner's basis in the property at 1105 D Street, S. W., sold by him in 1957, or as to his basis in the property at 38 Myrtle Street, N. E., sold by him in 1960. The record herein does not show that respondent erred in the adjustment made by him with regard to the gain realized by petitioner in the sale of the College Park Airport property as reported by him in his 1960 return.

These properties were not held by petitioner primarily for sale to customers in the ordinary course of his business as a dealer in real estate and the gains resulting from such sales constituted long-term capital gains.

Miscellaneous Transactions in addition to the Kent, Weaver Terrace, and MacArthur Boulevard Properties.

On March 1, 1946, William D. and Genevieve K. Goodman conveyed property located at 1620 Wilson Boulevard, Arlington, Virginia, to Adele K. Steinman who was a straw man acting on behalf of the petitioner. By deed dated October 17, 1957, Adele K. Steinman conveyed the property to the petitioner for a nominal consideration. Petitioner reported the following rents from 1620 Wilson Boulevard in his income tax returns for the years 1948 through 1959, the legends "(G)" and "(N)" denoting gross and net rentals, respectively:

1948	$3,852.41 (G)	1954	$2,775.00 (G)
	2,936.11 (N)		1,542.21 (N)
1949	3,656.74 (G)	1955	300.00 (G)
	2,581.48 (N)		(608.38) (N)
1950	3,675.62 (G)	1956	1,950.00 (G)
	3,241.35 (N)		875.94 (N)
1951	3,935.50 (G)	1957	3,291.15 (G)
	2,308.36 (N)		1,626.43 (N)
1952	4,000.00 (G)	1958	4,411.20 (G)
	3,650.05 (N)		1,836.18 (N)
1953	2,495.50 (G)	1959	416.15 (G)
	1,400.77 (N)		118.07 (N)

The cost of the property to Murray in 1946 was $32,056.61. On February 17, 1959, Murray conveyed the Wilson Boulevard property to Stanley Rakusin and Robert I. Silverman for $50,000.

The property known as 1620 Wilson Boulevard was acquired and held by petitioner as an investment and the gain from such sale constitutes long-term capital gain.

On June 1, 1958, Murray bought a building located at 301 Broad Street, Falls Church, Virginia, for $278,013.08. In December of that year he made improvements to the property at a cost of $126,685.60. Murray's income tax returns indicate that he rented this property to the Post Office Department. The following is a schedule of the gross (G) and net (N) rentals reported by Murray:

1958	$ 6,509.94 (G)
	(9,336.81) (N)
1959	34,704.88 (G)
	(5,657.58) (N)
1960	25,776.50 (G)
	(4,701.50) (N)

The net losses in rentals received arose from substantial interest expenses and depreciation.

On September 6, 1960, petitioner conveyed the 301 Broad Street property to Charles and William, Inc., for $387,-918.01. At the time of sale the total depreciation deductions taken on the improvements amounted to $36,889.58.

The property known as 301 Broad Street was acquired and held by petitioner as an investment and the gain received upon its sale is taxable as a long-term capital gain.

In two separate transactions on February 11 and March 1, 1955, petitioner purchased unimproved property known as the "Adams" or "Potomac" property from Charles C. and Lucille Moore and Boulevard Heights, Incorporated. The cost of this property was $90,265.35. This property was included in a deed of trust securing a note in the amount of $224,000 given by the petitioner to the National Mortgage and Investment Corporation on April 23, 1956.

On February 21, 1958, the petitioner conveyed the Adams property to Adams Properties Inc. for $255,000.

The profit was reported on the installment basis by the petitioner beginning in 1958.

During the period of time that petitioner owned this property he derived no income from it.

The property known as the "Adams" or "Potomac" property was held by petitioner for sale in the ordinary course of his trade or business as a dealer in real estate. Consequently, the gain received by petitioner upon its sale is taxable as ordinary income.

In 1960 and 1961 petitioner collected $380.71 and $424.30 on an installment sale which he made in 1945. Petitioner reported the taxable portions of said collections, or $357.75, and $398.71 respectively, as long-term capital gain, and respondent has determined that said amounts should be treated in 1960 and 1961 as ordinary income.*

Opinion.

Kern, *Judge:* The principal questions presented for our decision are whether the petitioner is entitled to treat as capital gains amounts received by him during the years in issue from the sales of various pieces of real estate or options (or contracts) to buy real estate, or whether, as respondent has determined, all of such gains constitute ordinary income. The dispute between the parties also includes additional questions the two more important of which are (1) whether petitioner properly claimed a deduction for demolition expenses and an abandonment loss relating to the demolition of a bakery building, and (2) whether he reinvested the proceeds of three sales of realty parcels made under threats of condemnation in property under circumstances which justify the nonrecognition of the gain resulting from the sales.

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*Revised by Order of July 1, 1965; *infra*, p. 78.

The governing statute with respect to the principal question is section 1221[5] of the Internal Revenue Code of 1954. It provides that the term "capital assets" does not include property held *primarily* for sale to customers in the ordinary course of a taxpayer's trade or business. Accordingly, it is necessary for us to decide in this proceeding whether each of the pieces of real estate or contractual interests therein, the sales of which gave rise to the taxable income here involved, constitute "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." However, it is obvious that the necessity for making these decisions is dependent upon our resolution of the more basic question which is whether petitioner was engaged in the business of dealing in real estate during the pertinent years in the course of which business properties were held for sale. Petitioner contends that he was not engaged in such a business but was merely an investor.

This is not an "either-or" question, i.e., a conclusion that petitioner was an investor in real estate does not preclude a conclusion that he was also (and simultaneously) engaged in the business of dealing in real estate. See *Nelson A. Farry*, 13 T.C. 8; *Walter R. Crabtree*, 20 T.C. 841; *D. L. Phillips*, 24 T.C. 435, 445; and *Randolph D. Rouse*, 39 T.C. 70, 76. In the instant cases we accept petitioner's contention that he was an investor in real estate but we conclude, contrary to petitioner's contentions, that

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[5] SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

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he was also engaged in the business of dealing in real estate and/or contractual interests therein during the years involved in these proceedings.

The question of whether a taxpayer is engaged in the business of dealing in real estate and the subsidiary questions of whether specific sales of property are sales of property primarily held for sale in the ordinary course of that business or constitute liquidations of investments are essentially factual in nature, and each case considering such a question necessarily turns upon its own peculiar facts. *D. L. Phillips, supra; Raymond Bauschard*, 31 T.C. 910, 915, affd. 279 F. 2d 115. There is no one decisive test by which this question may be determined. *Tidwell* v. *Commissioner*, 298 F.2d 864, affirming a Memorandum Opinion of this Court; *Ralph J. Oace*, 39 T.C. 743. The courts have developed a number of factors which should be considered. Among these criteria which have evolved are: (1) The purpose for which the property was acquired; (2) the purpose for which the property was held; (3) the improvements and their extent which were made to the property by the taxpayer; (4) the frequency, number, and continuity of the sales; (5) the extent and substantiality of the transactions; (6) the nature and extent of the business of the taxpayer; (7) the extent of advertising to promote sales, or the lack of such advertising; (8) the listing, if any, of the property for sale directly or through brokers. See *John D. Riley*, 37 T.C. 932, 938, affd. 328 F.2d 428, and *Broughton* v. *Commissioner*, 333 F.2d 492, affirming a Memorandum Opinion of this Court.

No single factor or criterion is entitled to the same weight in each case in which it may appear. *C. E. Mauldin*, 16 T.C. 698, 709, affd. 195 F.2d 714; *John D. Riley, supra* at 938. However, the purpose for which the property was "held' at the time of the sale or exchange is more significant than the purpose for which it was acquired. *Ackerman* v. *United States*, 335 F.2d 521. See also *Donald J. Lawrie*, 36 T.C. 1117.

During the period 1948 through 1963 it is apparent from our Findings that petitioner made numerous sales of real estate and/or contractual interests therein. These sales transactions involved many millions of dollars. Moreover, the gains derived from them constituted the greater part of his income. During the period 1948 through 1963 Murray realized net gains from the sales of real estate and/or contractual interests therein in the total sum of approximately $3,500,000. In addition, he received net gains from sales of real estate held by joint ventures of which he was a member in the total sum of over $800,000. During the same period he received net rental income in the total amount of approximately $70,000, and interest income in the total amount of approximately $410,000. During the taxable years 1957 through 1961 he realized net gains from the sales of real estate and/or contractual interests therein in the total amount of approximately $1,190,000 while the total interest income for those years was approximately $99,400 and his rental income reported in his returns for those years was in the total loss figure of approximately $324,000.

Because of the number and continuity of Murray's sales of real estate and/or contractual interests therein, the extent and substantiality of such transactions, the nature and extent of petitioner's business, and our conclusion based on the entire record that many items of such property were acquired and held by him, not for the purpose of obtaining income from them as an investor but for the primary purpose [6] of realizing a profit from their sale as a dealer, we are of the opinion that Murray was in the business of selling real estate and/or contractual interests therein during all of the years here in question.

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[6] We reach this conclusion regardless of whether the word "primarily" as used in the statutory phrase "held by the taxpayer primarily" is construed to mean "substantially" or to mean "of first importance" or "principally." See *Municipal Bond Corporation*, 41 T.C. 20, and the opinion of the Court of Appeals reversing on this point 341 F. 2d 683.

We recognize that some of the factors referred to above, such as the lack of advertising or listing for sale, are favorable to the contention of petitioners on this question. While we are unable to ascribe the weight to them which petitioners urge, under the facts of these cases, we have not ignored them in our resolution of the problem presented.

While this conclusion is warranted in our opinion, by a consideration of Murray's real estate activities alone, it is buttressed by a consideration of the activities in this field of Stewart's Corner, a corporation wholly owned and controlled by Murray.[7]

Having reached this conclusion, it becomes necessary for us to examine the several transactions here involved and to determine as to each of them whether the property sold was property held by him primarily for sale to customers in the ordinary course of his business as a dealer in real estate and/or contractual interests therein, or was property held by him not primarily for that purpose but in his role as an investor in real estate.

The Gordon Tract

Petitioner advances several arguments in connection with his contention that the profit resulting from the sale of his interests in the Gordon Tract should be considered as a long-term capital gain.

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[7] Petitioners' objections to the testimony adduced in connection with these activities were overruled. Their subsequent motions to strike are hereby denied. As to the relevancy of such testimony, see *Broughton* v. *Commissioner*, 333 F. 2d 492, affirming a Memorandum Opinion of this Court; *Kaltreider* v. *Commissioner*, 255 F. 2d 833, 838, affirming 28 T.C. 121. As to petitioners' argument under section 7213 (a) (1) I.R.C. 1954, see *Blair* v. *Oesterlein Co.*, 275 U.S. 220, 227. As to their argument based on the alleged inconsistency of respondent, see *William Fleming*, 3 T.C. 974, affd. 155 F. 2d 204.

He first argues that there is no presumption of correctness with regard to respondent's determination of deficiency on this issue since respondent by his examination and acceptance (after making minor adjustments) of petitioner's returns for the prior years in which the profit from this transaction was reported as long-term capital gain has in effect made determinations inconsistent with the determinations of deficiency involved in these proceedings. This argument is without merit. As we said in *Municipal Bond Corporation*, 41 T.C. 20, 32, reversed and remanded on other grounds, 341 F.2d 683, "[t]hat * * * [respondent] accepted without question petitioner's earlier returns in which the payments were treated differently [from respondent's determination in the taxable year] does not *in any manner offset the validity of his present determination* or afford any basis for estoppel." (Emphasis supplied.) A corollary argument advanced by petitioner appears to be that since respondent by his actions or lack of actions with regard to petitioner's return for 1955 determined that the profit derived from the Gordon Tract transaction was a long-term capital gain in that year and there has been no change in law or fact since that year, the installment payments received by petitioner in the years before us must be considered as long-term capital gains. As we have indicated above, the respondent made no "determination" with regard to petitioner's return for 1955 which would preclude us from considering on its merits the question of whether respondent erred in his determination in the instant cases that petitioner's net receipts from the Gordon Tract transaction constituted ordinary income rather than long-term capital gains, or would in any way affect the validity of the determinations of deficiency here involved.

Similar arguments are made by reference in petitioners' brief with regard to the issue having to do with the sale of the Berry Option. In our opinion they are similarly without merit.

On the merits petitioner argues that he acquired the contract to purchase the Gordon Tract and intended to use the land covered thereby for the purpose of mining it for sand and gravel, marketing and selling the merchantable timber thereon, and ultimately creating ground rents, and therefore his interests in the Gordon Tract were acquired and held by him as an investor and not as a real estate dealer. The only evidence of such alleged intent and purpose was the unsupported self-serving testimony of Murray himself. It is not corrobrated by the circumstances. Murray had never been interested in any way in the sand and gravel or timber businesses and took no actions with regard to the Gordon Tract in 1955 or at any time thereafter, which would indicate an intent to use the Gordon Tract for such purposes. Murray's testimony concerning his intent to create ground rents is vague. There is nothing in the record to indicate that he ever owned ground rents. There is nothing in his testimony as to how he intended to create them. The case of *Welsh Homes, Inc.*, 32 T.C. 239, affd. 279 F.2d 391, indicates that ground rents are frequently created in Maryland for the purpose of capitalizing (at least temporarily) the profits from the ultimate sales of lots from a real estate development. There is nothing in Murray's testimony to show any other purpose. Accordingly, on the record before us, we are unable to conclude, even if we should accept Murray's testimony on this point, that his avowed intent to create ground rents if and when he exercised his contractual right to purchase the Gordon Tract was inconsistent with his acquisition of the property in the role of a dealer in real estate, or that it was a factor indicating acquisition of his interests in the property in his role as an investor in real estate.

The record clearly shows that Murray did not receive and made no attempt to receive any rental income or other income which can be considered as investment income from any of the interests he acquired in the Gordon Tract. The

record is equally clear to the effect that he entered into negotiations to sell these interests shortly after their acquisition and did sell them. They included the contractual right to purchase the property owned by the Gordon heirs, a contract * to purchase the Pimm-Berry property, and the title to other properties in the so-called Gordon Tract which had been acquired by him. The ultimate sales made by him to Mar-Dill were of real estate and/or contractual interests therein. As we have already concluded, Murray was in the business of dealing in such property. Accordingly, and in the absence of any convincing proof that such items of property were acquired and held by Murray in his role as an investor, we conclude that they constituted property held by him primarily for sale in the ordinary course of his business, and that the proceeds of the sales thereof constituted ordinary income.

In reaching this conclusion we have not failed to consider all of the factors pertinent to this question which we have heretofore mentioned and discussed, including the fact that Murray engaged in no activities promoting the sales. While this is a pertinent factor, it is our opinion that under the facts of these cases it is not controlling and does not outweigh other factors which we consider support and require the conclusion we have reached. The fact that among the items sold to Mar-Dill were the contract to purchase from the Gordon heirs and the contract covering * the Pimm-Berry land, to the assignments of which the signature of Grace Murray was not required, is, in our opinion, irrelevant. See section 1234,[8] Internal Revenue Code of 1954.

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* As corrected pursuant to Order dated July 1, 1965; *infra*, p. 79.

[8] SEC. 1234. OPTIONS TO BUY OR SELL.

(a) Treatment of Gain or Loss.—Gain or loss attributable to the sale or exchange of, or loss attributable to failure to exercise, a privilege or option to buy or sell property shall be considered gain or loss from the sale or exchange of property which has the same character as the property to which the option or privilege

Berry Option

Most of what we have written with regard to the Gordon Tract transaction is equally applicable to the issue having to do with whether the proceeds from the sale of the so-called Berry Option should be taxed as long-term capital gains or as ordinary income. Petitioner has made much the same arguments with regard to respondent's treatment of his income tax returns for prior years in which a part of these proceeds was reported as capital gains, with regard to his intention to acquire this option as a step forward the creation of ground rents, and with regard to the fact that the property to which this issue relates was an option. For the reasons which we have already stated, we find these arguments to be unconvincing.

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relates has in the hands of the taxpayer (or would have in the hands of the taxpayer if acquired by him).

(b) Special Rule for Loss Attributable to Failure to Exercise Option.—For purposes of subsection (a), if loss is attributable to failure to exercise a privilege or option, the privilege or option shall be deemed to have been sold or exchanged on the day it expired.

(c) Non-Application of Section.—This section shall not apply to—

(1) a privilege or option which constitutes property described in paragraph (1) of section 1221;

(2) in the case of gain attributable to the sale or exchange of a privilege or option, any income derived in connection with such privilege or option which, without regard to this section, is treated as other than gain from the sale or exchange of a capital asset;

(3) a loss attributable to failure to exercise an option described in section 1233(c); or

(4) gain attributable to the sale or exchange of a privilege or option acquired by the taxpayer before March 1, 1954, if in the hands of the taxpayer such privilege or option is a capital asset.

In connection with petitioner's argument relating to the fact that the property sold was an option we add that in our opinion petitioner's business of dealing in real estate included the dealing in contractual interests therein. This view, it seems to us, is corroborated by the fact that in prior years there were two specific instances shown by the record when Murray acquired and sold such interests, viz., the acquisition and sale of his contract to purchase land from the Gordon heirs and the acquisition and sale of his contract * to purchase the Pimm-Berry land as a part of the Gordon Tract transaction.

With regard to this issue we have also concluded, after a consideration of all of the pertinent factors heretofore referred to, that the so-callet Berry Option constitutet property held by Murray for sale in the ordinary course of his business in the absence of any convincing proof that it was acquired and held by him in his role of an investor. Accordingly, the proceeds of the sale thereof constituted ordinary income.

The Holmes Bakery

With regard to the issue invoking the question of whether the proceeds received by Murray from the sale of the Holmes Bakery property constituted capital gains or ordinary income, we have reached a different result.

Our Findings established that petitioner's first plan regarding the Holmes Bakery was to purchase it as a going business for the oldest son to operate. Following his son's death petitioner temporarily lost interest in acquiring the Holmes Bakery. His interest was subsequently revived, however, and, after negotiations were completed for the purchase of the business, petitioner's son-in-law began to work at the plant. The son-in-law was trained to replace the general manager of the business who could

* As corrected pursuant to Order dated July 1, 1965; *infra*, p. 79.

not be prevailed upon to stay on a permanent basis after Murray acquired the business.

After approximately 4 months, Murray concluded that the bakery business was too complex for him to operate. He then sold the baking equipment and routes to the General Baking Company and rented the Holmes Bakery Building to that company for a short time. Examinations of the building by architects indicated that the building was in good condition and needed few improvements to meet the District of Columbia specifications for warehouses. He decided to rent it for that or a similar use. Murray carried on negotiations to rent the premises with The Mayer Furniture Company and had an estimate made of the cost of the improvements to the building which that prospective lessee would require.

Offers were also made by Murray to lease the premises to the General Services Administration and to the Government Printing Office. Although Murray was unsuccessful in finding a tenant for the premises, there is nothing in the record to indicate that the offers he made and the negotiations he carried on to lease the premises were other than bona fide. Murray began the demolition of the bakery building after he had repeatedly failed to find a suitable tenant for the improved premises and subsequently sold the premises to a purchaser interested only in acquiring the unimproved real estate.

On the basis of the record and after due consideration of all the pertinent factors heretofore discussed, we conclude that the Holmes Bakery property has not held by the petitioner primarily for sale to customers in the ordinary course of his trade or business. The Holmes Bakery property was acquired and held by Murray as an investor and constituted a capital asset in his hands. The gain upon the sale was taxable as a long-term capital gain under section 1221 of the Internal Revenue Code of 1954. *Nelson*

A. Farry, supra; Altizer Coal Land Co., 31 T.C. 70; *Sproul Realty Co.*, 38 T.C. 844; *Randolph D. Rouse, supra.*

Respondent also determined that petitioner was not entitled to a loss of $364,337.58 claimed for the year 1957 as a result of the demolition of the Holmes Bakery Building. He also determined that petitioner's claimed deduction of demolition expenses of $17,532.43 with respect to this property is not allowable. Respondent argues that "petitioner purchased the property with the intent to demolish the building, offered the property for sale without the building, and sold the property with the understanding that it be removed." Under these circumstances, he urges that the petitioner is neither entitled to the loss nor the demolition expense deduction.

The question is whether the loss claimed by petitioner is properly considered a demolition loss under section 165(a)[9] of the Internal Revenue Code of 1954. The governing regulation is section 1.165-3(a),[10] which provides

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[9] SEC. 165. LOSSES.

(a) General Rule.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

[10] § 1.165-3 Demolition of buildings.

(a) *Intent to demolish formed at time of purchase.* (1) Except as provided in subparagraph (2) of this paragraph, the following rule shall apply when, in the course of a trade or business or in a transaction entered into for profit, real property is purchased with the intention of demolishing either immediately or subsequently the buildings situated thereon: No deduction shall be allowed under section 165(a) on account of the demolition of the old buildings even though any demolition originally planned is subsequently deferred or abandoned. The entire basis of the property so purchased shall, notwithstanding the provisions of § 1.167(a)-5, be allocated to the land only. Such basis shall be increased by the net cost of demolition or decreased by the net proceeds from demolition.

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in part that no demolition loss can be claimed when the taxpayer purchases real property with the intention of either immediately or subsequently demolishing the building situated thereon.

We do not think that Murray intended to demolish the Holmes Bakery Building at the time when he acquired the real property here involved. Rather, he first intended to operate a bakery business on the premises and when that proved too difficult he formed an intention to lease it and entered into a leasing arrangement with the General Baking Company. When the General Baking Company terminated its lease, the petitioner made repeated efforts during the latter part of 1955, 1956, and the first part of 1957 to rent the building to the General Services Administration, the Government Printing Office, and other private tenants for use as a warehouse or office building. All of these efforts met with no success.

During the first part of 1957 Murray negotiated with representatives of The Mayer Furniture Company who expressed interests in using the Holmes Bakery Building as a warehouse and delivery quarters. However, The Mayer Furniture Company required structural changes which the petitioner estimated were too costly and therefore impractical in view of the expected rent. The negotiations with The Mayer Furniture Company were then terminated.

Following a second rejection of a proposed lease by the General Services Administration in May 1957 Murray decided to demolish the building. He began the demolition in late May 1957. The initial demolition work was done by some of his workmen and his son.

While the bakery building was in the process of being torn down, Murray began negotiations for sale of the premises with Parkwood, Inc., the ultimate purchaser. He conducted these discussions with Victor J. Orsigner, who acted on behalf of Parkwood, Inc. A preliminary contract of sale was drawn up on July 9, 1957, and an initial letter

agreement was signed by Murray and Orsinger on July 16, 1957. The final contract was signed on October 10, 1957.

After beginning the demolition work, the petitioner concluded that the task was too great to be performed by his own employees. He then turned to a professional demolition contractor and executed a contract for the demolition of the Holmes Bakery Building on July 24, 1957. The professional wrecking began 5 days later and was completed in early November 1957.

Although it was expressly provided in the agreement of sale that the petitioner was to demolish the existing structures on the premises, we find that the demolition occurred independently of the sale of the property. Murray intended to demolish the property and began the demolition almost 2 months prior to his commencement of negotiations with the representative of Parkwood, Inc. Upon this state of the record, we find that the petitioner is entitled to the demolition loss for the Holmes Bakery, and that the cost of this demolition was a properly deductible expense. *Cf. Standard Linen Service, Inc.*, 33 T.C. 1, 18; and *Blumenfeld Enterprises, Inc.*, 23 T.C. 665, aff'd 232 F.2d 396.

In view of our findings and conclusion on this issue, it appears that the figure used by petitioners as the basis for the Holmes Bakery property ($463,764.14) is correct. In any event the amount of such basis can be agreed to or determined under Rule 50.

Georgetown University Sale

In January 1957 petitioners sold certain properties located on the corner of 6th and D Streets, N.W., Washington, D.C., to Georgetown University. Two of these properties, 404 and 414 [11] 6th Street, N.W., were acquired by

[11] 414 6th Street, N.W., was purchased by Murray but title thereto was conveyed to Stewart's Corner as a straw man for Murray. Although Stewart's Corner joined with petitioners in conveying all the lots to Georgetown, the entire gain was properly reported by petitioners in their individual return.

petitioners on August 13, 1956, and September 28, 1956. The four other acquisition dates occurred prior to the above two, and can be found in our Findings, *supra*.

Respondent determined that petitioners realized ordinary income in 1957 in the amount of $75,548.33 [12] upon the sale of all the properties to Georgetown University. He contends that this property was held primarily for sale to customers in the ordinary course of petitioner's trade or business. If we find to the contrary, respondent argues in the alternative that the gain received from the sale of 404 and 414 6th Street, N.W., constituted short-term capital gain in the amount of $25,182.77 because these two parcels were held for less than 6 months and represented one-third of the assemblage sold to Georgetown University.

Petitioner urges that the gain from the sale to Georgetown University of all the lots except those known as 404 and 414 6th Street, N. W., constitutes long-term capital gain because the properties were not held primarily for sale in the regular course of any business of petitioner but for investment. With regard to the sale of 404 and 414 6th Street, N. W., he contends that no gain was realized on the sale of these properties and that respondent's alternative allocation of gain is inappropriate because the record contains petitioner's basis in each property and the corresponding amount received upon each sale.

The record establishes that all of the Sixth Street properties (except the lot known as 414 6th Street, N. W.) were under a 1-year lease at an annual rent of $33,000 (renewable for two successive 2-year periods at annual rentals of $36,000 and $37,800 but terminable by the lessor on 90 days' notice if the lessor sold the property "for the purpose of construction of a building" thereon) at the time of the sale to Georgetown. Although petitioner demolished the structures located upon 406-8, 410, and 412 Sixth Street, N. W., these properties continued as income-pro-

[12] For an explanation of this gain, see footnote 2, *supra*.

ducing investments held by the petitioner until the sale to Georgetown University in January 1957. Once the University ascertained that it could not use this land, the petitioner purchased the property back from Georgetown in December 1963 at approximately the same prices as those for which it was sold. At the time of trial the property continued to be owned by petitioner and was subject to a 99-year lease with an annual rent of $100,000. Moreover this lease provides for a minimum annual rent of $180,000 beginning in 1966.

In view of the above, we do not believe that the Sixth Street properties were held in January 1957 primarily for sale to customers in the ordinary course of petitioner's trade or business. Although* we have held that Murray, in addition to being an investor in real estate, was also engaged in business as a dealer in real estate and/or contractual interests therein, we are of the opinion that the sale to Georgetown University was not a sale by him as a dealer of property held by him primarily for sale in the ordinary course of his business as such a dealer. On the contrary, it is our conclusion that the petitioner acquired and held this property as an investment and sold it to Georgetown at a price far below the fair market value in order to assist the University in acquiring a site for a new law school. Since the repurchase from Georgetown, the petitioner has held all of the Sixth Street properties and received substantial rents therefrom.

After due consideration of all of the pertinent factors heretofore discussed and in light of the special circumstances of the sale, coupled with the fact that the property has produced and continues to produce substantial rental income for the petitioner, we conclude that the petitioner acquired and held this property as an investment and that the sale to Georgetown was a capital transaction which should be taxed at capital gains rates.

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* See order of 6/3/65; *infra*, p. 72.

However, since 404 and 414 Sixth Street, N. W., were held for less than 6 months, the gains derived from their sale constitute short-term capital gain. Petitioners are in error in contending that there were no gains realized upon the sale of these two properties. The record shows that their bases in 404 and 414 Sixth Street, N. W., were in the respective amounts of $49,889.89 and $52,827.45. Since the respective prices received for these two properties were $50,238.35 and $55,521.69, the total short-term capital gain realized by petitioners from this transaction was $3,042.70. The balance of the gain realized by the petitioners from this transaction ($72,505.63) constituted long-term capital gains.

Involuntary Conversion

The question for our decision with regard to this issue is whether or not the proceeds from the involuntary sales of property owned by the petitioner located at 1105 D Street, S. W., and 38 Myrtle Street, N. E., in the District of Columbia, and the involuntary sale of the property located at the College Park Airport, College Park, Maryland, were used to purchase other property similar or related in service or use to the converted property under circumstances and at times which would make applicable section 1033(a)(3)(A)[13] of the Internal Revenue Code of 1954.

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[13] SEC. 1033. INVOLUNTARY CONVERSATIONS.

(a) General Rule.—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

(3) Conversion into money where disposition occurred after 1950.—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) Nonrecognition of gain.—If the taxpayer during the period specified in subparagraph (B), for the purpose of

Petitioner argues that the three purchases of properties located on D Street, which occurred on June 27 and July 20, 1955, and May 1, 1959, and the payment of the mortgage on the College Park Airport tract were made from the proceeds of these three sales. He contends that these were purchases of "other property" within the meaning of the nonrecognition of gain provisions of section 1033.

We have set out in our Findings the facts relating to these properties which concern the dates of the threats or imminences of the condemnation of the properties sold by Murray, the dates of the sales of such properties by him, the amount realized upon such sales, and the dates of his alleged acquisition of other properties similar or related in service or use to the converted properties.

Petitioner urges that the threat or imminence of conversion resulting in his sale of 1105 D Street, S. W., occurred on June 21, 1951, and the threat or imminence of

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replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe. For purposes of this paragraph—

(i) no property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(ii) the taxpayer shall be considered to have purchased property or stock only if, but for the provisions of subsection (e) of this section, the unadjusted basis of such property or stock would be its cost within the meaning of section 1012.

conversion resulting in his sale of property at 38 Myrtle Street, N. E., occurred on October 17, 1957, on which dates large areas in which these properties were located were "designated" by a public agency, referred to in the record as the District of Columbia Redevelopment Land Agency, as sites for urban renewal or slum clearance projects. The only evidentiary basis for this contention is the unsupported testimony of the petitioner which was in effect the opinion of a not disinterested layman as to a conclusion of law. His own witness, an employee of the Land Agency, testified that the authority of the Land Agency to condemn these properties did not come into existence until the respective dates of December 5, 1956, and September 25, 1959. From the testimony of the same witness and exhibits identified by him, it is evident that no one in the employ of the Land Agency notified or purported to notify Murray of any threat or imminence of condemnation of these properties until the respective dates when the authority to condemn them came into existence. *Cf. Frank O. Maixner,* 33 T.C. 191; Rev. Rul. 63-221, 1963-2 C.B. 332.

A witness of petitioner also established that the authority to condemn the airport property did not exist, and that there was no threat or imminence of its condemnation until November 25, 1959.

Therefore, the purchases of property on D Street, N. W., made by Murray in 1955 antedated not only the involuntary sales here involved but also the threat or imminence of any condemnation thereof; the purchase of property on D Street, N. W., made by Murray on May 1, 1959, antedated not only the involuntary sales made by Murray in 1960 but also the threat or imminence of any condemnation thereof; and the purchase of the property on D Street, N. W., made by Murray on May 1, 1959, occurred more than 1 year after the close of the first taxable year in which gain was realized by Murray from the sales of property made by him in 1957.

Accordingly, section 1033(a)(3)(A), *supra*, is inapplicable to these transactions by reason of the provisions of section 1033(a)(3)(B).[14]

Petitioner further argues that the payment of $49,200 made in February 1960 on the mortgage covering College Park Airport should be considered as a purchase of replacement property with the meaning of section 1033. We do not agree. The discharge of a debt secured by real property does not transfer title to the property from the creditor to the debtor. It merely removes an encumbrance from the property. Therefore, payment of a mortgage is not an acquisition of "other property" within the meaning of section 1033(a)(3)(A). See I.T. 1378, 1922-2 C.B. 26; I.T. 2700, 1933-2 C.B. 73.

Because of our holding with regard to petitioner's qualification for the postponement of gain provisions of section 1033, we must now consider whether the gains received from the involuntary conversions constitute long-term capital gains or ordinary income.

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[14] SEC. 1033 (a)(3)(B). Period within which property must be replaced.—

> The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—
>
> (i) one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or,
>
> (ii) subject to such terms and conditions as may be specified by the Secretary or his delegate, at the close of such later date as the Secretary or his delegate may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

The relevant provision of the statute is section 1231 [15] of the 1954 Code. It provides that gains from the involuntary conversion of "property used in the trade or business" are to be taxed at long-term capital gains rates. The term "property used in the trade or business" is defined in section 1231(b)(1) as property "of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, * * *." However, section 1231(b)(1) excludes property properly includable in inventory and property "held by the taxpayer primarily for sale to customers in the *ordinary course of his trade or business*" from the definition "property used in the trade or business."

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[15] SEC. 1231. PROPERTY USED IN THE TRADE OF BUSINESS AND INVOLUNTARY CONVERSIONS.

(a) General Rule.—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply; and

(2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than

Since the three properties here involved had been held by petitioner for more than 6 months prior to their involuntary conversions and were subject to allowances for depreciation, the gains resulting from the sales made by petitioner because of threats of condemnation are to be taxed as long-term capital gains unless we should find that they were properties "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Thus the crucial question here is the same as in the issues previously discussed and determined even though arising under a different section of the Internal Revenue Code.

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6 months shall be considered losses from a compulsory or involuntary conversion.

In the case of any property used in the trade or business and of any capital asset held for more than 6 months and held for the production of income, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft.

(b) Definition of Property Used in the Trade or Business.—For purposes of this section—

(1) General Rule.—The term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 month, and real property used in the trade or business, held for more than 6 months, which is not—

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or

(C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in paragraph (3) of section 1221.

* * * * * * * *

Our Findings have set out in detail the rents received from all of these properties before they were sold, and the rent received from the College Park Airport before and after part of that tract was sold. The record indicates that 1105 D Street, S. W., and 38 Myrtle Street, N. E., had been held by petitioner for many years as income-producing investments until the time of their involuntary sales. While the College Park Airport property had been held for a shorter length of time prior to its involuntary sale, the record shows that substantial rentals therefrom had been received by petitioner prior to its sale and that he continued to receive and still receives substantial rentals therefrom since he retained ownership of a part of the tract and the right to use and possession of the part sold subject to a 30-day notice of development by the vendee.

After consideration of this question in the light of all the pertinent factors heretofore discussed, we have concluded that these three properties were held by petitioner as investments and were not properties held by him primarily for sale in the ordinary course of his business as a real estate dealer. Accordingly, the gains resulting from the involuntary conversions of the properties are taxable as long-term capital gains.

Miscellaneous Transactions

Petitioner and one Weitzman operating as joint venturers acquired piecemeal lots in Washington, D. C., which comprised properties referred to in the record as Kent, Weaver Terrace, and MacArthur Boulevard. The first parcels were acquired in 1945 and their acquisitions of property in this locality were completed in 1946. It appears from the record that two of these pieces of real estate were unimproved and that a building located on the other was demolished in 1954. The joint ventures incurred expenses such as taxes and interest in connection with these properties, one-half of which reflected as deductions in peti-

tioners' individual tax returns. No rental income was derived by petitioner from these properties, except a small amount of rent for a few years (averaging a loss figure) from the building on the MacArthur Boulevard property demolished in 1954. Parts of these properties were sold by petitioner and Weitzman in 1950 and 1955, and the gains therefrom were reported in petitioners' individual tax returns as long-term capital gains. The remainder of the property was sold by petitioner and Weitzman in 1957, and one of the questions presented here is whether the gain from this transaction is taxable as ordinary income or as a long-term capital gain.

We have already concluded that petitioner in addition to being an investor in real estate was also engaged in the business of dealing in real estate. The present question therefore is not whether petitioner was engaged in the business of dealing in real estate (a question we have already decided) but whether the particular properties here considered were acquired and held by petitioner as investments or were acquired and held by him as properties held primarily for sale in the ordinary course of his business as a dealer in real estate. On the precise question involving the proper characterization of particular pieces of real estate (or contractual interests therein) as investments or properties held primarily for sale, we have already indicated our view that important factors are the receipt by the taxpayer during the time he holds the property of substantial rentals from the property or the receipt of rentals over a long period of years or the taking of steps which clearly indicate the intention of the taxpayer to use the property for the production of rental income, such as, for example, the making of substantial improvements thereon. The presence of these factors would indicate that the property was acquired and held as an investment. With regard to the three properties here involved, none of these factors is present.

We are of the opinion that the evidence herein does not show that respondent erred in his determination that the gain realized by petitioner from the sale of these three properties in 1957 constituted ordinary income.

Petitioner, in addition to arguments presented, considered and rejected with reference to issues already decided by us, argues that the fact that these properties were acquired and held by petitioner and Weitzman as joint ventures is in some way a factor favoring his contention on this issue. We are unable to agree.

Petitioner also contends that the 1957 sale was in effect forced on him by Weitzman. The only testimony as to this is the unsupported self-serving testimony of Murray which we are unable to accept at its face.

In reaching the conclusion as to this issue, which we have stated above, we have not failed to consider the length of time for which these properties were held or the fact that no active sales campaign was carried on with regard to these properties.

We reach the same conclusion with regard to the so-called "Adams" or "Potomac" property. It appears from the small amount of testimony in the record dealing with this property that it was held by Murray for a relatively short period of time before its sale, that no rental income was derived from it, and no steps were taken indicating an intention to derive income from its use. There was nothing unusual about its sale.

However, with regard to the properties known as 1620 Wilson Boulevard and 301 Broad Street, we have reached a different conclusion. Murray received substantial rental income from 1620 Wilson Boulevard for approximately 13 years prior to its sale. While Murray held the 301 Broad Street property for a shorter time, he made substantial improvements on it in the year of its acquisition and received substantial rental income from it for several years

thereafter. Considering these facts, and all other pertinent factors, we have concluded that the sales of these two properties constituted liquidations of investments rather than sales of property held by Murray primarily for sale in the ordinary course of his business as a dealer in real estate.

The amounts of the gains realized by petitioner in these transactions (which we have considered in this Opinion as "Miscellaneous Transactions") are not in dispute.

Petitioner has failed to prove that respondent erred in his determination that the taxable portions of receipts in the amounts of $380.71 and $424.30 in 1960 and 1961 from an installment sale made in 1945 constituted ordinary income rather than capital gain.*

Decisions will be entered under Rule 50.

JEROME S. MURRAY and GRACE H. MURRAY, *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 10670.

UNITED STATES COURT OF APPEALS
FOURTH CIRCUIT.

Argued Dec. 9, 1966.

Decided Jan. 6, 1967.

On Petition to Review the Decision of the Tax Court of the United States.

Stanley Worth, Washington, D. C. (Scott P. Crampton, Joseph A. McMenamin and Korner, Doyle, Worth & Crampton, Washington, D. C., on brief), for petitioners.

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* As revised by order of July 1, 1965; *infra*, p. 79.

Lawrence B. Silver, Attorney, Department of Justice (Mitchell Rogovin, Asst. Atty. Gen., Meyer Rothwacks and Fred R. Becker, Attorneys, Department of Justice, on brief), for respondent.

Before HAYNSWORTH, Chief Judge, and BRYAN and J. SPENCER BELL, Circuit Judges.

PER CURIAM:

This is a petition for review of a decision of the Tax Court finding that certain sales of real estate made by the husband were sales of capital assets, while other sales of real estate or of contractual interests in real estate, were of property held primarily for sale to customers in the ordinary course of Murray's business.

For the reasons stated by the Tax Court,[1] we deny the petition. Judge Kern's opinion is entirely consistent with the subsequent decision of the Supreme Court in Malat v. Riddell, 383 U.S. 569, 86 S.Ct. 1030, 16 L.Ed.2d 102. Nothing in *Malat* requires a modification of the result in the Tax Court.

Affirmed.

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[1] Jerome S. Murray and Grace H. Murray v. Commissioner of Internal Revenue, T.C. Memo. 1965-148.

In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-27

JEROME S. MURRAY AND GRACE H. MURRAY,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner[1] brought this suit for refund of 1965 federal income taxes in the United States Court of Claims. Insofar as is here relevant, petitioner claimed that the proceeds of two installment sales of real property should be characterized as capital gains, and not, as the Commissioner had determined, as ordinary income. The sales themselves had been made in 1945 (the Wilson property) and in 1955 (the Gordon property). In a suit involving taxes for 1957 and 1961, the Tax Court had determined that the sale of the Gordon property had been made by petitioner in the course of his business as a real estate dealer and the gain on the sale was therefore ordinary and not capital. *Murray* v. *Commissioner*, 24 T.C.M. 762 (Pet. App. 39a-106a), affirmed *per curiam*,

[1] All references will be to petitioner Jerome S. Murray, whose wife is a party only because they filed a joint income tax return.

370 F. 2d 568 (C.A. 4) (Pet. App. 106a-107a), certiorari denied, 389 U.S. 834.

In the court below, the government moved for partial summary judgment on the ground that the prior litigation collaterally estopped petitioner's renewed claim that the proceeds from the sale of the Gordon property should be treated as capital gain. This motion was granted and petitioner's suit with respect to that issue was dismissed on May 15, 1970 (Pet. App. 3a-15a). After a subsequent trial before a commissioner on March 30, 1973, the court adopted (Pet. App. 38a) the commissioner's recommended decision (Pet. App. 16a-37a) that the gain on the sale of the Wilson property also was ordinary and not capital. Petitioner here challenges the court's holdings on both issues.

1. The court below, in granting summary judgment with respect to the proceeds from the sale of the Gordon property, correctly applied the doctrine of collateral estoppel in accordance with *Commissioner* v. *Sunnen*, 333 U.S. 591. Petitioner contends that *Malat* v. *Riddell*, 383 U.S. 569, which was decided after the Tax Court decision in petitioner's previous suit but before that decision was affirmed by the Fourth Circuit on appeal, constituted an intervening change in the law that barred the application of collateral estoppel. But this contention is wrong for two separate reasons. First, since petitioner's prior suit was not terminated until after the decision in *Malat* v. *Riddell*, that decision in no sense "intervened" between petitioner's two suits. There has been no change in the applicable law since termination of petitioner's prior suit. Thus the normal principles of estoppel apply to this suit.

Second, as both the Fourth Circuit on petitioner's earlier appeal (Pet. App. 107a) and the court below (Pet.

App. 13a) recognized, the original Tax Court decision was consistent with this Court's subsequent holding in *Malat* v. *Riddell*. The issue in *Malat* was whether, for purposes of the definition of "capital asset" in Section 1221 of the Internal Revenue Code of 1954, 26 U.S.C. 1221, property is held "primarily for sale to customers" when the taxpayer's substantial but not principal purpose in holding the property is to sell it in the ordinary course of business; this Court held that unless selling in the ordinary course of business is the taxpayer's *principal* purpose, the property would be treated as a capital asset. In petitioner's first suit, the Tax Court expressly held (Pet. App. 84a, n. 6) that the Gordon property had been held by petitioner as a real estate dealer for the *principal* purpose of sale in the ordinary course of business and that it was therefore not a capital asset. Thus, *Malat* did not represent a change in the law as it had been applied to petitioner.

2. Petitioner challenges the decision below with respect to the Wilson property solely on the ground that the finding concerning his principal purpose in holding that property was erroneous. That factual issue warrants no further review. Moreover, the finding—that petitioner held the property principally for sale in the ordinary course of business—was supported by substantial evidence. During the year of sale, petitioner had owned 44 properties similar to the Wilson property and had sold 21 of those properties (Pet. App. 23a-24a). There was ample evidence showing that petitoner's standard operating procedure was to buy properties for renovation, short-term rental and sale, *i.e.*, that he was a dealer, not an investor (see Pet. App. 23a-25a).[2]

[2] Petitioner claims (Pet. 13-14) that the court below applied an erroneous burden of proof standard. But the court indicated that petitioner in fact had simply failed to adduce *any* evidence of "any pupose other than resale at a profit in the regular course of his real estate business" (Pet. App. 25a).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

AUGUST 1973.

DOJ-1973-08